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MBA PROFESSIONAL REPORT

Residential Communities Initiative: A Case Study

**By: Michael R. Zahuranic and
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December 2003**

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RESIDENTIAL COMMUNITIES INITIATIVE: A CASE STUDY

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Submitted in partial fulfillment of the requirements for the degree of

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RESIDENTIAL COMMUNITIES INITIATIVE: A CASE STUDY

ABSTRACT

The purpose of this MBA Project was to investigate and provide a comprehensive overview of the Residential Communities Initiative within the US Army. This project was conducted with the assistance of the Monterey Bay Housing Program Executive Office and the Program Manager for Residential Communities Initiative. The goal of this project was to analyze this initiative and compare the way the Army is privatizing housing with the initiatives that the US Navy and US Air Force are utilizing. We also wanted to use Monterey Bay as a case study to investigate how RCI was instituted at an installation and analyze this from a business and contracting standpoint.

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EXECUTIVE SUMMARY

Military housing is in trouble. Chronic under funding for military housing has left the Department of Defense with a \$16 billion housing repair bill for 177,000 inadequate housing units. The Army alone has a \$7 billion revitalization deficit. The Army estimates that 70% of its housing units need extensive renovation or complete replacement. However, stable or declining military budgets, especially Military Construction (MILCON) budgets, offer no relief. Congress is unlikely to appropriate the \$7 billion, and the services are unlikely to forsake important weapons systems in favor of constructing houses.

The second chapter reviews the historical context of military family housing, from the Revolutionary War period to present day. The third chapter presents the Military Housing Privatization Initiative and its alternative authorizations. It will discuss the Army, Navy and Air Force's approach to privatization and how each services utilizes the twelve alternative authorizations to improve the housing of its members.

The fourth chapter reviews the Residential Communities Initiative on the Monterey Peninsula. It will discuss the stakeholders involved in the process, the change management techniques used, and the source selection process followed by the RCI office.

RCI will work at the sites where there is considerable competition from private-sector housing. At those sites the commercial marketplace will require that the RCI corporations produce and maintain acceptable family housing. Otherwise, Army families will simply choose to live elsewhere. BAH, which reflects actual costs of housing in specific locations, will give them the resources to choose the private sector.

RCI will also probably work at more isolated sites. The RCI corporations will probably produce the required number of family housing units. The issue at such sites will be the quality of the housing, the maintenance, and the associated amenities. The Government participation in the corporations will tend to keep quality at an acceptable level, mitigating the worst abuses of the monopolies. Without competition, it seems certain that housing will not be as nice at the isolated sites.

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I. INTRODUCTION

A. THE PROBLEM

Military housing is in trouble. Chronic under funding for military housing has left the Department of Defense with a \$16 billion housing repair bill for 177,000 inadequate housing units. The Army alone has a \$7 billion revitalization deficit. The Army estimates that 70% of its housing units need extensive renovation or complete replacement. However, stable or declining military budgets, especially Military Construction (MILCON) budgets, offer no relief. Congress is unlikely to appropriate the \$7 billion, and the services are unlikely to forsake important weapons systems in favor of constructing houses. As President Bush stated in a speech to military personnel,

No aspect of our current defense posture is more worrisome than the decline in the standard of living of our service members and their families that has taken place in recent years. Reversing this trend and improving their quality of life is a principle authority of my Administration. We owe you and your families a decent quality of life. (Clark, 2003)

During the past four decades, housing for military personnel and their families has been a relatively low priority. After a rapid expansion of what was then considered modern and up-to-date accommodations throughout the 1950s and 1960s, the effort and funding devoted to the construction and the upkeep of military housing did not keep up with the natural deterioration and changing societal definitions of adequate housing. The decrease in quality accelerated since the end of the Cold War as a result of the uncertainties of base closures, both at home and overseas, and shrinking defense budgets, which have encouraged the channeling of construction funds into projects more related to operational readiness. (Else, 2001)

Approximately one-third of military families live in government-owned housing, with the remainder living in privately owned homes or rental accommodations. Of the one-third, DoD determined that more than half of their homes do not meet its current housing standards with regard to space and amenities. The Department calculated that, by using its traditional methods of contracting and construction, it would need 30 years and \$16 billion to resolve its family housing shortfall. (Else, 2001)

Traditionally, DoD uses a combination of two methods to house active duty personnel and their families. The principal method is reliance on the commercial housing supply near military installations: for which Congress provides members with a cash allowance to defray most of the cost. Over the years this cash allowance lagged behind rental costs in such high-cost areas as Monterey, California. Recognizing this shortfall, the current administration is committed to closing the gap between housing allowances and rental costs. As President Bush proclaimed in his fiscal year 2002 Management Agenda, published by the Office of Management and Budget (OMB),

The Administration is committed to reducing to zero by 2005, the average out-of-pocket expense of military families living in private housing in local communities. This will enable more military families to leave inadequate government housing and rent quality private-sector housing in the local communities around DoD's installations.

The second method, intended for those locations where local housing is extraordinarily expensive or unavailable, is lodging members and their families in quarters built with appropriated funds on military reservations. (Else, 2001)

In 1996, Congress offered DoD a third housing method—the Military housing Privatization Initiative (MHPI). MHPI was created in Section 2801 of the National Defense Authorization Act for 1996 (PL104-106) as a five-year pilot program within a 10-year plan to resolve the general military housing problem. Through the use of its alternative authorizations, Congress intended to improve military housing quickly and economically by leveraging the federal investment by encouraging private investment. This project examines how the services, especially the Army, implemented MHPI. Furthermore, this project will take a close look at how the Army implemented this initiative in and around Monterey, California.

B. RESEARCH OBJECTIVES

This paper will provide a brief history of housing in the military and the need for change. The Army chose to adopt a housing policy they call the Residential Communities Initiative (RCI). We will discuss how the leaders of the Army decided on this policy, the process used to select contractors as housing partners, the roadblocks to change, and the implementing strategies utilized by the Army to implement this change focusing on the Presidio of Monterey/Naval Postgraduate School, Monterey, CA.

C. RESEARCH QUESTIONS

- Given inadequate funding to repair and rebuild military family housing, how will the Army accomplish the required revitalization?
- How did the Army transfer housing to public-private housing corporations while maintaining oversight and ensuring the men, women and their families receive adequate housing?
- What is the Residential Communities Initiative (RCI), and what distinguishes it from other military housing programs?
- How did the leaders in the Army decide on the Residential Communities Initiative?
- How did Monterey's RCI Program Manager implement the Residential Communities Initiative at the Presidio of Monterey, the Naval Postgraduate School, and Fort Ord military community?
- What can the Army learn from the way other services are implementing the Military Housing Privatization Initiative?
- What impact might privatized housing have on retention rates?

D. SCOPE, LIMITATIONS, AND ASSUMPTIONS

1. Scope

- Review the history of military housing.
- Review the Military Housing Privatization Initiative and the authority given to each service.
- Review the programs each service adopted under MHPI and look at several examples of programs already under way.
- Analyze the Residential Communities Initiative's acquisition process and consider whether it will provide the best value housing to the Army.
- Review and analyze the Army's Residential Communities Initiative program on the Monterey Peninsula.

2. Limitations

While this project includes information on all of the services, it is not intended to be a detailed analysis of the Navy/Marine Corps or Air Force's housing privatization initiatives. Rather, it will compare those service's housing initiatives to the Army's Residential Communities Initiative. Also, financial data, including profit margins are sensitive information. The Army's RCI offices consider this information to be proprietary and, therefore are reluctant to make it available.

3. Assumptions

There are several assumptions critical to this project.

- While the military forces' size and structure continually fluctuate, manning levels will not increase or decrease by more than 20%.
- Congress will not appropriate the \$7 billion needed to provide adequate housing in the next five to ten years due to the costs associated with the war on terrorism as well as future weapon systems.
- While OMB and Congressional interpretations of Budget Scoring will evolve, they will not change enough to seriously affect the DoD's approaches to housing privatization.
- Military installations can be grouped logically for multiple awards using a single solicitation.
- Industry will continue to participate in this new approach regardless of the installations' locations. However, it is recognized some locations may be more desirable than others and that location may impact/affect negotiated contract terms and conditions.
- Basic Allowance for Housing will continue to be authorized by Congress and will keep pace with housing costs.
- Pressures from the commercial housing market will ensure that public-private housing corporations build and maintain adequate military housing.

- In those locations where the commercial housing market is inadequate to ensure the performance of public-private housing corporations, other mechanisms can be constructed to ensure such performance.

E. METHODOLOGY

This project is based on an extensive literature review, including Congressional testimonies, Federal agency reports from both the Congressional Research Service and the General Accounting Office, Defense Department and Service component regulations, reports, journal articles, written texts, extensive MHPI and RCI websites, web searches, previous thesis', and interviews conducted with MHPI program personnel as well as service component personnel.

F. DEFINITIONS AND ABBREVIATIONS

See Appendix A

G. ORGANIZATION OF THE STUDY

This project is organized into five chapters. Chapter II provides a historical context for how military family housing originated and progressed through the Cold War. It also includes an overview of traditional MILCON-funded housing programs and three previous military family housing privatization programs. Chapter III details the origin and scope of the Military Housing Privatization Initiative and the programs each of the services adopted under this initiative, to include the acquisition process utilized by each service. Chapter IV looks at the Residential Communities Initiative program at the Presidio of Monterey/Naval Postgraduate School and details the change and acquisition process from military housing to privatized housing. It discusses change management techniques utilized by the program office and military leaders as well as the acquisition process. Chapter V provides our independent analysis of the Army's privatization program and whether this program will provide the Army and its service members and families the best value housing available.

Figure 1 - 1: Artist's Rendering of the Ord Military Community under RCI



Source: From Monterey RCI website

II. HISTORICAL BACKGROUND

A. INTRODUCTION

This chapter reviews the historical context of military family housing, from the Revolutionary War period to present day. It includes overviews of the Quartering Acts, the U.S. Constitution's Third Amendment, housing the military from 1790 thru World War II, the Cold War era military family housing programs, legislative effects on Cold War housing programs and eligibility criteria to live in military family housing.

B. WHY DOD PROVIDES MILITARY FAMILY HOUSING

1. The Quartering Acts

The Quartering Act of 1765 required colonial governments and citizenry to provide housing and expendable supplies to British troops stationed in the American Colonies. Where sufficient barracks were not available, troops were to be housed in privately owned structures. Specifically, the act stated that ... civil officers ... are hereby required to billet and quarter the officers and soldiers, in barracks provided by the colonies; and if there shall not be sufficient room in the said barracks for the officers and soldiers, then and in such case only, to quarter and billet the residue of such officers and soldiers for whom there shall be no room in such barracks, in inns, livery stables, ale houses, victual ling houses, and the houses of sellers of wine by retail to be drank in their own houses or in places thereunto belonging, and all houses of persons selling of rum, brandy, strong water, cyder or metheglin ... uninhabited houses, outhouses, barns, or other buildings, as shall be necessary, to quarter therein the residue of such officers and soldiers for whom there should not be room in such barracks and publick [sic] houses as aforesaid ... (Quartering Act of 1765)

The Quartering Act of 1774 was similar in substance to the 1765 Act, stating that ... where no barracks are provided by the colonies ... officers or soldiers in His Majesty's service shall remain within any of the said colonies without quarters for the space of twenty-four hours after such quarters shall have been demanded, it shall and may be lawful for the governor of the province to order and direct such and so many uninhabited houses, outhouses, barns, or other buildings as he shall think necessary to be taken (making reasonable allowances for the same) and make fit for the reception of such

officers and soldiers, and to put and quarter such officers and soldiers therein for such time as he shall think proper. However, this new Quartering Act allowed for the billeting of troops in occupied dwellings. (Quartering Act of 1774)

The Quartering Acts were part of a set of Parliamentary decrees, known as the “Intolerable Acts” that incensed colonists’ anger toward King George, substantially contributing to the revolutionary movement, and left an enduring scar on the colonial political leaders.

2. United States Constitution, Amendment 3

Amendment three to the U.S. Constitution states, “No soldier shall, in time of peace be quartered in any house, without the consent of the owner, nor in time of war, but in a manner to be prescribed by law.” Fifteen years after the second quartering act, preventing the forcible housing of soldiers by private citizens was still paramount to the constitutional writers. They ensured that private citizens and property owners could not be required to house soldiers except by passage of congressional legislation during wartime. This amendment forced the Secretary of War to provide organic housing for military forces, and not rely on the private rental market. It guided military personnel housing policy for over 150 years.

Not until the Capehart program ended in the early 1960s did DoD recognize that it would never attain its goal of providing housing for all military families. The local economy surrounding military installations became the primary housing source, funded by housing allowances, and on-base housing became secondary.

3. Housing the Military Prior to World War II

Before the Cold War, on-base (or shipboard) housing was the norm for personnel during peacetime and housing allowances played a limited role compared to today. For the married members of the small peacetime officer corps, this meant on-base DoD family housing. For enlisted personnel, who were not expected to have families, it meant assignment to barracks living quarters. Although married men could be drafted into the enlisted force during wartime, they were expected to leave their dependants at home. The U.S. Court of Claims even used the notion that DoD housing was the norm for military personnel in 1925 to confirm the tax-free status of housing allowance. In the court’s

view, allowances were not taxable compensation but simply reimbursement for an expense. (CBO, 1993)

As late as 1948, the Hook Commission, an advisory group appointed by the Secretary of Defense, assumed that sufficient DoD housing would eventually be available to house most military families in peacetime, and that allowances for housing would be the exception rather than the norm in the post-WW-II era. To support that assumption, members of the commission argued that military personnel preferred DoD housing located on military bases and stressed the relationship between on-base housing and military readiness. The Cold War intervened and the Hook Commission's expectations were never realized. Instead, the Career Compensation Act of 1949 established the Basic Allowance for Quarters (BAQ) system, providing housing allowances to service members when on-base housing was not available. BAQ became an important element of military compensation, and an invaluable pillar in alleviating the plight of military families and their housing problems. (CBO, 1993)

4. Post-WW-II Standing Military Expansion

The peacetime Army of the late 1940s was at least seven times larger than its predecessor of the 1930s. As the wartime cooperation between the Soviet Union and the United States deteriorated into the Cold War, it gradually became apparent that the peacetime Army required after World War II would be larger than any peacetime Army in American History. Among the many problems confronting the Army was the problem of providing family housing. (Baldwin, 1996)

Both military and civilian housing was in short supply in the years immediately following World War II. With the end of WW-II, the late 1940s saw 15 million American service men and women returning home. This situation, coupled with a housing shortage that grew steadily between 1928 and 1948, exacerbated an already existing general civilian housing shortage in the United States. In 1946, roughly 9% of American families lived two or three couples to a single family home. (ACHP Report, 31 May 2002)

The general housing shortage, and a historically large peacetime military force, made obtaining housing extraordinarily difficult for military families. For the first time

in the history of our nation, the build-up of nuclear weapons in the years immediately following World War II resulted in a need to maintain a large peacetime fighting force. Secretary of Defense Louis A. Johnson summarized the acute military housing problem in 1949 when he said,

Rather than be separated from their families because of lack of Government quarters and scarcity of adequate rental housing at their places of assignment, many of the service personnel have accepted disgraceful living conditions in shacks, trailer camps, and overcrowded buildings, many at extortionate rents. It cannot be expected that competent individuals will long endure such conditions ...there is nothing more vital or pressing in the interest of morale and the security of America than proper housing for our armed forces. (ACHP Report, 31 May 2002)

C. TRADITIONAL MFH WITH MILCON

Congress funds the Defense Department's budget through yearly appropriations. Since 1960, the Defense Department's budget has been divided into seven appropriations titles:

- Military Personnel
- Operations and Maintenance (O&M)
- Procurement
- Research, Development, Test, and Evaluation (RDT&E)
- Military Construction (MILCON)
- Family Housing (MFH)
- Revolving and Management Funds

The Family Housing title is sub-divided into four major functional categories:

- Construction (New, Post-acquisition, Planning and Design)
- Operations and Maintenance (including utilities)
- Debt Payments
- DoD Family Housing Improvement Fund (funds MHPI)

Both the new construction and the post-acquisition functional categories of the Military Family Housing appropriation title is specifically earmarked by installation and by project. There is virtually no opportunity for spending discretion below Congressional level. (FMR, June 2002) Because Congress controls Military Family Housing spending

so tightly, the process of perceiving a housing need, justifying it, requesting and receiving funds, and planning/executing the project can be inordinately long. The lag time from project conception and justification, through budget cycles and appropriations, and culminating in a military family housing unit ready for assignment and occupation ranges from four to ten years, with the latter being closer to the norm. During this time, the project is subject to derailment by competing budgetary and political priorities within DoD and Congress. As a result, DoD family housing requirements historically outpaced military family housing funding for unit construction, renovation and operation. (Sorce, 2000)

D. PREVIOUS MILITARY FAMILY HOUSING PRIVATIZATION PROGRAMS

1. Wherry: 1949-1955

The Wherry program required no direct Congressional funding and was intended to increase MFH supplies around bases that were not scheduled for downsizing or closure. Private developers (sponsors) designed, built, owned, operated and maintained the housing on either private land or land leased from DoD at nominal rates. Wherry land leases ran for a period of not less than 50 years and some leases ran for 75 years. To encourage developer participation and competition, the Federal Housing Administration (FHA) insured the private mortgages for up to 90% of the property's replacement value or a maximum of \$8,100, which limited Wherry house construction costs to \$9,000 each. FHA also required the housing to meet its standards for design, construction, and livability. (Baldwin, 1996)

Even when built on land leased from the Government, Wherry housing was not considered government quarters. Although private sponsors had to give priority to service members who wanted to live in Wherry units, the units were considered commercial rental housing, open to non-military occupancy. Soldiers and officers chose to rent voluntarily and paid their rent using their basic allowance for quarters to the private sponsor. Rental rates, however, were not determined by the amount of the housing allowance. FHA established rental schedules for the units based on its estimate of the income sponsors would need to operate and maintain the housing, repay the mortgage, and make a profit. At a congressionally mandated maximum interest rate of

4%, the sponsors would pay off the mortgage in slightly less than 33 years. (Baldwin, 1996)

Congress and Wherry sponsors had differing views regarding time horizons for project profitability. Wherry contracts and FHA rental rates were structured to provide sponsors with nominal profits during the first 33 years, while they repaid construction loans. Meaningful profit opportunities occurred during the 17 to 42 years after completing loan repayments. Congress viewed this as a fair incentive for sponsors to maintain the properties and to fulfill the 50 to 75 year leases. Sponsors viewed the 33-year nominal profit period as excessively long and unfair, making it difficult to attract sponsor developers and private financing. (Baldwin, 1996)

Wherry projects encountered numerous problems and the program was cancelled in 1955, after building 84,000 sets of quarters. Congress investigated reports of developers earning windfall profits through building code and maintenance shortcuts.

Service components complained that the \$9,000 houses were too small, poorly constructed and poorly maintained. With the advent of larger Capehart housing units (discussed below) Wherry vacancy rates increased and sponsors complained of financial losses. Wherry units included no rental or occupancy guarantees, and private citizen tenants were rare. (Baldwin, 1996)

Although FHA and DoD recognized local taxation as a possible problem when the program was established, the rental schedules included no allowance for the expense of local taxation. In the spring of 1956, the Supreme Court ruled that local governments could tax Wherry projects. Wherry owners immediately applied for rental increases, but such increases made Wherry housing less attractive to service members and increased the already high vacancy rates. Preferring Government operations and maintenance, and intent on ending the Wherry controversy, Congress authorized the purchase of Wherry units in 1956. By 1959, the service components purchased and renovated about 70% of the units whose average size was 831 square feet. (Baldwin, 1996)

2. Capehart: 1955-1964

In 1955, Congress authorized a new MFH program, sponsored by Senator Homer Capehart (R-IN) intended to correct Wherry program flaws. Under the new program, the FHA provided mortgage insurance for private sponsors who built, but did not operate,

family housing units on government-owned or leased land. The Secretary of Defense had to certify the need for family housing at an installation in order to initiate a project. The services retained architect-engineer firms to design the projects, whose designs were then advertised for competitive bidding. (Baldwin, 1996)

The winning bidder formed a separate corporation for each project and obtained mortgage insurance for 100% of his bid from the FHA. Insured against risk by this mortgage guaranty, the corporation obtained a 25-year mortgage from a private lender. Congress limited the mortgage rate to 4% to encourage affordable mortgages. The corporation also reimbursed the service component for the design costs. Initially, FHA capped the mortgage insurance limit at \$13,500 per unit but later raised it to \$16,500. The increase accounted for housing industry inflation and allowed for larger, more desirable, quarters than Wherry permitted. (Baldwin, 1996)

After completing Capehart construction projects, the sponsor turned the corporation over to the service component, which assumed the mortgage obligation. The project became government quarters assigned to families of service members who forfeited their housing allowance. The services used the forfeited housing allowances to pay off the mortgages, and operated and maintained the projects using appropriated funds. Capehart added 115,000 units to the MFH inventory between 1955 and 1962. (Baldwin, 1996)

Capehart housing drew Congressional criticism from its inception. Some complained that mortgage repayment, over a 25-year period, was substantially more expensive than building with appropriated funds. Others questioned the need for mortgage insurance since the Government, which was essentially immune from default, assumed the obligations at project completion. The General Accounting Office (GAO) even accused the services of spending excesses on “costly and desirable, but not essential features, such as air conditioning and dishwashers.” By 1960, Capehart was rapidly falling out of favor. Inflation increased interest rates to 4.5% and forced mortgage limits up to \$19,800. Disputes with contractors and ballooning costs caused the Kennedy administration to retire the Capehart program in 1962, with Congress voting to build MFH exclusively with appropriated funds. That year, Congress authorized almost 14,000

new MFH units, the largest single authorization since the Korean Conflict, but appropriated funds for only one-half that amount. (Baldwin, 1996)

Although Wherry and Capehart provided almost 200,000 new housing units for military families, popular sentiment had turned against privatization initiatives. In 1959, Roland Boyd, a Texas lawyer and general council to the Wherry Housing Association said, if a mistake had been made in the program, it was the turning of ownership, operation and management of military housing over to private industry. The military and private enterprise are not compatible in the field of ownership and management of military housing. Both Senator Wherry and Senator Capehart conceded that building housing with appropriated funds would be best, but both argued that the Defense Department would not or could not maintain a long-term program of housing construction because of the many demands on its resources. The decade of the 1960s would prove them right. The first post-Capehart appropriated housing program was drastically reduced before it left Congress, and in a few years the war in Southeast Asia pushed housing to a low priority. (Baldwin, 1996)

3. Vietnam Years

In the early 1960s, privatization programs fell out of favor with Congress, and the Defense Department returned to building MFH with appropriated (MILCON) funds. Although Congress pledged to continue the rapid pace of housing construction, the war in Southeast Asia soon relegated housing to a low priority. However, the Defense Department acknowledged that it would have to rely on the private community to provide most of its family housing. In areas where housing was not available, not adequate or not affordable, or where military necessity required it, the Defense Department would still provide military housing. In 1973, the nation adopted the all-volunteer force (AVF). To make military service more attractive to volunteers, Congress supported a brief surge of family housing construction with appropriated funds in the mid-1970s. But the budget priorities of the Carter administration in the late 1970s again reduced the level of family housing construction. (Baldwin, 1993)

The election of Ronald Reagan in 1980 brought to office an administration determined to rebuild American military strength and committed to using private enterprise to perform as many governmental functions as possible. But the cost of

erasing the Defense Department's housing deficit with appropriated funds was staggering and competed with the numerous other requirements for rebuilding the armed forces. Again, as they had done three decades earlier, Congress and the administration turned to the private sector for the capital to revitalize family housing. (Baldwin, 1993) Congress first authorized leasing at all military installations in 1962. But domestic short-term leasing remained a relatively small program. Leasing overseas expanded dramatically, however, in the mid-1970s as the Defense Department turned to this approach to provide much-needed family housing abroad. When the administration and Congress tackled the problem of military family housing in the early 1980s, they had a variety of options to consider from the rich, but often misunderstood, history of Defense Department housing privatization programs. (Baldwin, 1993)

By 1980, family housing became a high priority for the Defense Department due to demographic changes among the troops. While the proportion of married officers was always high, the proportion of married enlisted personnel had grown steadily since the end of World War II and especially after the formation of the AVF. DoD leadership increasingly recognized the influence of family issues on morale and reenlistment and in 1983 declared that support for military families was described as “an organizational imperative.” (Baldwin, 1993)

4. Section 801 and 802 Leasing Programs of the 1980s

In the Military Construction Authorization Act for Fiscal Year 1984 (Public Law 98-115), Congress enacted, and President Ronald Reagan signed into law, legislation that established two new pilot programs for military family housing. Dubbed the “801” and “802” programs after the sections of the act that established them, the programs attempted to tap the resources of the private sector to improve military family housing. Armed with a series of inducements and guarantees, the Defense Department hoped to persuade private developers to build family housing on or near military installations and make that housing available to service members. Better family housing, the Defense Department argued, would improve morale and encourage reenlistment. While these factors are critical to any armed force, they were especially important for a rapidly expanding, all-volunteer force, which was just a decade old. As the Reagan

administration launched its post-Vietnam buildup of American forces, family housing, like manpower and hardware, would benefit from increased military spending. (Baldwin, 1996)

The Section 801 and 802 programs were touted as the complete solution to DoD's long-standing housing problem. During congressional testimony in 1983, Lawrence Korb, Assistant Secretary of Defense for Manpower, Reserve Affairs and Logistics said the new 801/802 programs would

maximize private initiative, benefit the community, minimize government involvement, increase freedom of choice for all people in choosing housing, and greatly reduce the Government's short and long-term costs.

Section 801/802 MFH was rented primarily to military service members. Although service members were not officially required to accept 801/802 units, they were strongly advertised and supported by the installation housing offices. For service members, 801/802 units were easy to obtain and less costly than other private sector housing when traditional on-post housing was not available. Eligible military personnel voluntarily rented the units, using their housing allowances, and paid their own utilities out of pocket. Rental rates were determined jointly between DoD and the developers, and were described as "reasonably equivalent to comparable rental units in the community." The private developer operated, maintained and managed the housing units. The developer risked losing his lease/rental guarantee if maintenance and management support was inadequate. The Defense Department had the right of first refusal to acquire the units at the end of the leases. (Baldwin, 1996)

Both 801 and 802 were initially designated as two-year pilot programs. Congress renewed them annually before modifying them and making them permanent housing options in 1991. Reluctant to relinquish any budget control to DoD, 801/802 deals required Congressional approval after the service components negotiated/structured the deals with private developers. The Congressional Budget and Impoundment Control Act of 1974 required specific language in the contract agreements stating that "the obligation of the United States to make payments under the agreement in any fiscal year is subject to the availability of appropriations for that purpose," and is commonly referred to as the 'subject-to-availability-of-funds' clause. This provision made private developers

skeptical of the Government's long-term intentions, significantly hampering efforts to encourage private investment in 801/802 projects, and leading to a slow start for the programs.

a. Section 801, Before 1991: "Build-to-Lease"

Section 801 was significantly more successful than its 802 cousin. It was called 'build-to-lease' because developers built the housing units after winning competitive bid processes, entered into lease agreements with service components and obtained Congressional approval. The projects required new unit construction, built either on-post or off-post, in accordance with local building codes, rather than DoD construction standards. Off-post units were to be located within 30 miles and a 60-minute commute from the installation, and were subject to local property taxes. The leases were 20 years in length, allowing either contractor or Government operations and maintenance.

The service component paid rent, in the form of lease payments, in return for filling all units with military personnel. The rent was funded from a pool of money derived from forfeited housing allowances. Service members forfeited receipt of their housing allowance and paid their own utilities out-of-pocket. Rental prices were based on the Government's leasing contract with the developer and not connected to housing allowance rates.

b. Section 801, Problems and Revisions

Section 801 projects immediately encountered a host of difficulties but managed to produce housing units throughout the 1980s. Projects were significantly delayed as developers negotiated lower, more favorable tax rates with local governments, and tried to avoid Davis-Bacon wage rates. The Department of Labor eventually ruled in favor of the labor unions, upholding Davis-Bacon wages, thereby prompting developers to ask for additional funding since the higher Davis-Bacon wage rates were not priced into bids. The services argued that the lower property taxes and the associated delays while contractors negotiated them were adequate offsetting values for the higher wages. Another source of controversy regarded the Government's responsibility to ensure the projects' adherence to construction codes. DoD claimed it had only to 'monitor' the projects, since they were built to commercial standards, not DoD codes; and that local governments and investors shouldered the duty to 'inspect.' The General Accounting

Office (GAO) agreed that DoD need only monitor the projects, but must more specifically define exactly what monitoring entailed. (GAO/NSIAD -87-13BR)

To obtain lower land costs, and consequently lower bid prices, some contractors sought land at the outer reaches of the 30 mile/60-minute range arc. At Fort Drum, New York, 801 residents complained of isolation from the Post and its associated facilities benefits, coupled with frequent and excessive commuting hazards, especially during winter weather. By 1986, section 801 still appeared favorably enough to DoD that the Department's policy was to obtain all future MFH through a 60/40 mix of MILCON and 801 programs. Congress was skeptical as to how 801 leasing could be less costly, in the long run, when compared to MILCON "ownership." They required that all 801 projects show at least a 5% cost savings when compared to MILCON before approving the lease arrangements. GAO was also skeptical, firmly believing that leasing was more expensive in the long run due to contractor profits, poor construction quality, and poor maintenance prospects. While not mandatory, GAO recommended the services include performance bonds in their contracts, to increase the probability of successful project completion with minimal financially related delays (GAO/NSIAD -87-13BR). The services, primarily the Army, had not used performance bonds, believing that a guaranteed long-term lease arrangement negated their usefulness, and only increased overall project cost. Congress modified the 801 programs in 1991, ending its pilot stage and making it a permanent MFH option. The changes included allowing for rehabilitated units to increase program flexibility and reduce costs, especially in urban areas.

Addressing GAO concerns, off-post construction was mandated. GAO argued that on-post projects were not operating leases, but were actually disguised capital leases, with significant legal and funding implications since the Government was effectively obligated to purchase the property at the end of the lease (GAO/NSIAD -87-13BR). Finally, DoD agreed to assume operations and maintenance functions, easing congressional fears of developers skimming maintenance dollars to boost profits and leaving service members to reside in substandard/unsafe conditions. GAO contended that, similar to Wherry projects, developers would lose interest in maintenance after the first seven or eight years of the lease, when maintenance costs increased and profit-boosting depreciation was exhausted.

c. Section 802, Before 1987: “Rental Guarantee”

This program was called ‘rental guarantee’ because the service component guaranteed that military personnel would occupy a minimum percentage (up to 97%) of the units, with the service filling the rental gap if occupancy was too low. To minimize the chances of a vacancy gap, 802 projects were restricted to bases where current military-controlled housing had exceeded a 97% occupancy rate for the preceding 18 consecutive months. This requirement could be waived for new installations or those expecting a large increase in military personnel during the 1980s expansion. Section 802 projects required new unit construction, built either on-post or off-post, in accordance with DoD construction standards, and subject to local property taxes. The rental guarantees lasted for a 15-year maximum, were not renewable, and specified contractor operations and maintenance. DoD was responsible for 80% of the property tax increases over the contract life.

Service members received their housing allowance, and forwarded it to the contractor as rental payment, paying for their own utilities out-of-pocket. To protect against escalating rental rates, only that portion of the rent devoted to operation and maintenance (maintenance rent) was allowed to rise over the contract period. Shelter rent was fixed over the contract life.

d. Section 802, Problems and Revisions

From the beginning, section 802 projects were unpopular with private developers. Since shelter rent was fixed over the contract life, and initial construction costs were capped at about 85% of the average occupants housing allowance, contractors envisioned inadequate profitability opportunities. By 1987, section 802 had produced no housing, and was “dying on the vine.” Congress revived the program by relaxing its parameters. Using local building codes and including rehabilitated units reduced construction costs and attracted private investor interest. Unfreezing shelter rent, permitting government O&M, and extending contract life spans to 25 years increased developers’ long-term profitability prospects. Lastly, for those projects built on Government land, lease renewal became an option, but was limited to the length of the original contract. By 1993, section 802 had produced only 276 units, and although authorized, its use was not pursued.

E. ELIGIBILITY

Eligibility refers to who is deemed qualified and deserving to live in MFH. Before 1949, marriage among the enlisted ranks was discouraged and reinforced by housing policy. Enlisted soldiers were assigned to barracks and paid for separate quarters out of their own pockets if they wished to bring their spouses/children with them to their duty stations. (Alt, 1991) Including junior enlisted personnel with families in the housing allowance system, like their inclusion in the system of DoD family housing, is relatively recent. The Career Compensation Act of 1949 marked the first time that most grades of enlisted personnel became eligible for cash housing allowances similar to those that officers received, but only at “without dependants” rates. Marriage among junior enlisted personnel was strongly discouraged. The 1949 act also made married “career” enlisted personnel (defined as corporals with seven years of service and all sergeants) eligible for public quarters, believing housing allowance “with dependants” was unnecessary since government housing program expansions would soon fill the need. Enlisted personnel struggled to meet housing needs throughout the 1950s and 1960s. Although some additional allowances were available for special dependency cases, advent of the all-volunteer force (AVF) in 1973 finally established housing allowance “with-dependant” rates for junior enlisted personnel. (CBO, 1993)

After 1973, all junior enlisted personnel with dependants became eligible for housing allowance, but not all were eligible for on-base government quarters. MFH was still restricted and described by Congress in 1983 as available to those personnel who “in all likelihood are committed to a career in the military.” Specifically, the minimum rank was set at “E4 with over 2 years of service, except when all eligible personnel are otherwise adequately housed.” (Baldwin, 1996) Because of congressional involvement in the section 801/802 programs, DoD gradually made all married enlisted personnel eligible for MFH. Today, MFH for married junior enlisted personnel is considered a valuable tool to encourage favorable first term retention decisions, to promote military family members’ overall well being, and to increase deployment readiness.

F. CHAPTER SUMMARY

While the Federal Government's housing policies regarding military families changed significantly over the last 200 years, one condition has pervaded the landscape. The supply of housing units available to military families has consistently lagged the demand for these units. Moreover, the questionable quality and low affordability of these structures led to additional hardships and sacrifices by service members and their families. Although Congress and the Defense Department have applied significant effort to eliminate the problem over the last 50 years, military family housing shortages and inadequacy issues still permeate military service today.

Figure 2 - 1: Artist's Rendering of Craftsman Junior NCO's Quarters



Source: From Monterey RCI website

III. SERVICE COMPARISON

A. INTRODUCTION

This chapter presents the Military Housing Privatization Initiative and its alternative authorizations. It will discuss the Army, Navy and Air Force's approach to privatization and how each service utilizes the twelve alternative authorizations to improve the housing of its members. Finally, it will discuss the process used by each service in selecting a contractor and the contractual relationship between the service and the contractor.

B. MILITARY HOUSING PRIVATIZATION INITIATIVE

In 1996, Congress and DoD tried something very different from traditional housing methods. Congress authorized DoD under the Military Housing Privatization Initiative, contained in the 1996 Defense Authorization Act (Appendix B), to privatize military housing. The Military Housing Privatization Initiative (MHPI) was devised to give the DoD a set of tools to entice private investment by encouraging DoD to act more like a private enterprise. Just as business can consider local real estate market conditions in customizing development projects, the MHPI was designed to give similar flexibility to DoD. This initiative was intended as a step away from the perceived one-size-fits-all mentality of earlier programs. (Else, 2001)

MHPI was created in Section 2801 of the National Defense Authorization Act for 1996 (PL104-106) as a five-year pilot program within a 10-year plan to resolve the general military housing problem. Through the use of its alternative authorizations, Congress intended to improve military housing quickly and economically by using relatively small federal contributions to leverage private investment. These alternative authorizations include:

- Conveyance of real property: The Government may transfer title of Federal property to private ownership.
- Relaxation of Federal specifications for housing construction: Builders are allowed to construct housing in accordance with local building codes.

- Inclusion of ancillary support facilities: Bids for contracts may incorporate additional amenities, such as child care centers and dining facilities, to enhance the attractiveness of the basic housing.
- Payment of rent by allotment: Landlords may receive payment of rents through automatic electronic fund transfer from the appropriate Federal disbursing facility, guaranteeing cash flow.
- Loan guarantee: The Government may guarantee up to 80% of the private sector loans arranged by the property developer.
- Direct Loan: The Government may make a loan directly to the contractor.
- Differential Lease Payment: The Government may agree to pay a differential between the BAH paid to Service members and local market rents.
- Investment (Joint Venture): The Government may take an equity stake in a housing construction enterprise.
- Interim Leases: The Government may lease private housing units while awaiting the completion of a project.
- Assignment of Service members: Service personnel may be assigned to housing in a particular project that they may otherwise not choose to occupy.
- Build to lease: The Government may contract for the private construction of a housing project, and then lease its units.
- Rental guarantee: The Government may guarantee a minimal occupancy rate or rental income for a housing project.

Originally, control of housing projects was centralized in OSD's Office of Competitive Sourcing and Privatization. But under OSD's direct control, projects were slow to develop. To encourage the services and to remove the perceived bureaucratic block, in October, 1998, the Secretary of Defense devolved operational responsibility for MHPI to the individual Services, retaining oversight and final approval authority in OSD's Office of Competitive Sourcing and Privatization. Central features of the MHPI are its flexibility and its decentralized execution. However, projects tend to follow similar progressions.

First, the appropriate service establishes the need for new or renovated housing at an installation through a site review and feasibility study. This examination includes an

evaluation of the local private housing market and a cost-benefit comparison between the use of an MHPI package and traditional construction methods. The Service briefs the results of the site review and feasibility study to OSD's Office of Competitive Sourcing and Privatization. If the concept is approved, the Service is authorized to develop an appropriate solicitation proposal. Congress is notified before the completed solicitation is issued to private industry. Congress is again notified when the successful solicitation response is selected and before a contract is awarded.

All of the privatization deals involve turning over housing allowances to developers over several decades in exchange for building, maintaining and managing housing on military bases. Developers borrow millions of dollars from banks and other financial institutions to begin new construction and renovation projects. They make their money back—in addition to a profit over the course of a typical 50-year deal—by receiving a steady income from housing allowances. (Cahlink, 2001)

DoD set only two ground rules for the services in setting their own privatization methods. Developers must pledge at least three times as much money as the military invests to get projects off the ground and they must eliminate inadequate housing by 2010. (Cahlink, 2001) John B. Goodman, Deputy Under Secretary of Defense for Industrial Affairs and Installations, issued a policy memo on 09 October 1998 containing MHPI project leverage requirements. The leverage ratio is a measure of the funds required to complete a housing project under MHPI compared to the amount of funds required to complete a project under traditional MILCON of identical scope and size. As stated in the memo, a privatization project must obtain a minimum three to one leverage ratio.

C. ARMY

After several studies, the Army chose Residential Communities Initiative (RCI) as its program. The goal of RCI is to eliminate inadequate Army housing in the United States by 2007. The three main objectives are (1) to create world class, quality residential communities, (2) to leverage assets/scarcely funds, and (3) to obtain private sector expertise, creativity, innovation and capital. Under the RCI, the Army will establish long-term business relationships (usually 50 years) with private sector developers for the purpose of improving military family housing communities. The

Army will provide the developer a long-term interest in both land and family housing assets. These developers will become the master community developers for the Army community. The primary source of financial return for the developers will be the revenue stream generated from the military personnel's basic allowance for housing (BAH) which will be paid as rent. (Army RCI webpage)

The Army-developer relationship is not essentially a contractual one. When the Army RCI PM speaks of "long-term business relationships," he is describing limited liability corporations or, in the case of Fort Hood, a limited liability partnership. For example, in Monterey the RCI Program leveraged the Army and Navy's equity in land and housing to "buy" 49% of Monterey Bay Military Housing, LLC, a limited liability corporation, chartered in California. That corporation then contracted with Clark Pinnacle Military Housing, LLC, to construct and manage new housing communities on the Presidio of Monterey, the Naval Postgraduate School, La Mesa Family Housing, and the Ord Military Community.

The only contracts involved in this corporate relationship are (1) the \$350,000 contract between the Army and Clark Pinnacle to produce a Community Development Management Plan and (2) any commercial contracts the Corporation lets for specific supplies and services.

1. Scope of RCI

The Army's privatization program began with four projects: Fort Carson, Fort Hood, Fort Lewis, and Fort Meade. The current plan for the Army includes 26 RCI projects that include over 72,922 homes in the United States. That equates to more than 80 percent of all Army family housing. As of August 2003, the Army has selected partners for eleven additional projects with the transfers of assets/operations expected to take place in late fiscal year 2003 or 2004.

The following map shows the Army's RCI sites as of October 2003. The Monterey project is the first joint-service project in MHPI.

Figure 3 - 1: RCI Sitemap



Source: *From Army RCI Webpage*

2. Acquisition Process

RCI focuses on residential communities (not just houses) and uses a two-step Request for Qualifications (RFQ) acquisition process that attracts quality developers who bring best practices/innovations to the Army's RCI program. See Figure 3-2 for a picture of RCI's selection process. At no point in this process is cost a factor. At the same time, the RFQ process reduces the time/costs for both the Army and the developers who participate in RCI. The process also seeks to evaluate/award on the basis that the firm selected is the most highly qualified to engage in discussions with the Army to create a mutually agreed upon business plan to meet the Army's requirements. (RCI Webpage)

The RFQ procurement approach allows the Army to:

- Provide greater flexibility in negotiating long-term agreements.
- Maximize opportunities for interchange between developers, locals, and the Army.
- Take advantage of partner innovation, creativity, and expertise.
- Provide opportunities to craft the best business and development plans.

- Provide a mechanism for consultation with OSD/Congress during the process.
- Promote competition by lowering entry costs for bidders to submit responses.
- Maximize competition because the private sector accepts this process.
- Create complex real estate plans with expertise/advice or expert consultants.

Figure 3 - 2: The RCI Selection Process in Monterey



Source: *Authors*

The Army publishes three Minimum Experience Requirements for an initial screen of qualified bidders, and then the Army announces the sites with a two-step RFQ. The three pre-qualifying factors include: 1) development, 2) property management, and 3) capital formation. The first step of the two-step RFQ process determines the competitive range for a group of sites using the following five evaluation factors. (RCI Webpage)

- Experience
- Financial Capabilities
- Organizational Capability
- Past Performance
- Small Business Plan

Government contracting personnel would recognize the first step in the Army's process as a formal source selection which does not consider cost and whose ultimate goal is define a competitive range of contractors qualified to become the Army's corporate partners in military housing construction and maintenance.

In fact, for all the Army's projects, the Army RCI PM prepares the first-step RFQ for a series of geographically related projects. The Monterey project, including both the Presidio of Monterey and the Naval Postgraduate School, was grouped with Fort Irwin, Parks Reserve Forces Training Area, and Moffett Federal Airfield. The Baltimore District of the Army Corps of Engineers issued the actual RFQ. Contractors interested in working with the Army on any or all of the projects submitted their qualifications. After contractor responses were received, a five-member Evaluation Board, including local RCI PMs and the Army RCI PM reviewed and ranked them. Twenty-two contractors submitted qualifications for the California group of projects. The board left only three contractors in its competitive range.

Step two of the process then allowed those in the competitive range to bid on any of the sites listed in step one as they are solicited. Step two used the following four factors and these factors are evaluated based on submissions and oral presentations.

- Preliminary Project Concept Statement
- Financial Return
- Organizational Capability (Installation Specific)

- Small Business Utilization Plan (Installation Specific)

Contractor proposals in response to the second step solicitation were evaluated locally. In Monterey's case, all three contractors in the competitive range made oral presentations. Those presentations were evaluated and Clark Pinnacle Military Housing, LLC, was selected to receive a contract to work with the Army to prepare a Community Development Management Plan.

3. Community Development Management Plan (CDMP)

Upon award, the Army and Clark Pinnacle worked together to craft a CDMP that set forth the terms of the developer's long-term relationship with the Army. The CDMP has three components: 1) Development, 2) Financial/Transactional, and 3) Operations and Property Management. The development plan consists of the master plan, the plan for renovation or construction, subcontracting and small business plan, and the schedule. The financial plan consists of the life-cycle cash flow, the sources and uses of finances, and the transitional instruments that will be utilized. The property management portion of the plan consists of operations, maintenance standards, the organizational chart/staffing, and the transition plan. (RCI webpage)

The Army lists the benefits of the CDMP process as:

- Allows the Army/developer to work through issues collaboratively, and ensures major issues are identified and addressed before execution of the plan.
- Provides a forum for the Army to consider proposals from the developer concerning the use of specific privatization authorities.
- Provides a mechanism for conferring with Congress, local communities, and other organizations to ensure the needs of all interested parties are considered.

The CDMP process takes about seven months to complete. During the first six months, the partner and the Army craft the CDMP. The Army then staffs the CDMP and submits it to Congress. If Congress does not object to the project, the Army issues a notice of Transition and the developer is paid \$350,000 for the CDMP. In return for this payment, the Army is granted full and unlimited rights to use the CDMP. Three months later, assets/operations are turned over to the partner, which is typically a limited partnership or limited liability company that includes the Army and the developer as partners. (RCI webpage)

Curiously, despite the fact that the Army pays developers for the CDMPs, the housing corporations treat them as entirely proprietary. Contracting personnel recognize contractors' tendency to stamp every page of their submissions "Proprietary." Stamping every page avoids real evaluations of which pages actually contain sensitive information, and they tend to limit the number of people who see the plans. Probably the Plans do contain some sensitive financial information, but limited amounts of sensitive information do not justify refusing to allow public scrutiny of Government documents.

For example, the Army RCI PM showed us a one-page schedule of planned construction and renovation at Fort Belvoir over the fifty-year life of the project. That schedule contained no financial information, but the PM refused to allow us to have a copy, claiming that the plan was proprietary. (Spigelmyer, 2003) Given the relative ease with which a CDMP could be "sanitized," it seems unlikely that Army RCI could withstand a Freedom of Information Act request for the documentation.

4. Portfolio and Asset Management (PAM)

Although RCI project award and transfer of assets/operations are more visible RCI activities, PAM functions are the most important because they are necessary to ensure that the Army's investment, assets, and portfolio are fully protected against any current and potential crisis and/or shortfalls over the next 50 years of the 28 RCI projects.

In the private sector, the primary benchmark for measuring success of a portfolio is financial return. While this measure is not the fundamental criterion for RCI PAM, the same underlying principles, strategies, tools, and approaches apply. To ensure this, RCI project performance is measured on:

- Soldier/Family Satisfaction
- Enhancement/Preservation of Housing
- Mitigation of Risk to the Project
- Successful Completion of the Development

To measure this performance, PAM is established at two levels. The first, Portfolio Management, includes the information required by Headquarters with the objective of assessing and assuring the overall success of RCI. Information collected and analyzed at Headquarters will also be provided back to the installation to enhance the success of individual projects. The second level, Asset Management, will focus on

information prepared/used by installations to assess the success of its project. (RCI Homepage)

The Army's approach to PAM also envisions tailoring its program to meet the specific need of each Army housing privatization project and to provide key lessons learned to enhance and improve the policies/procedures at existing projects as well as drive a "best practice" approach for future projects.

D. NAVY/MARINE CORPS

The Navy pioneered the MHPI effort in 1994 when it obtained authority from Congress to create Public-Private Ventures (PPV) as a way to correct its housing problems. Under this venture, a private company (typically a limited liability company) builds, maintains, and manages family housing communities in a partnership with the service. The Navy and Marine Corps view privatization not only as a way to improve housing, but also as an investment opportunity. The PPV arrangements require the services to take on a greater financial burden, but also enable them to share in the revenues generated by housing privatization. (Cahlink, 2001)

The limited liability companies can be used for developing housing on Navy bases and Government land, as well as on private land. The partnerships include many of the features pursued by other services, such as using housing allowances to pay for on-base housing. But the agreements also make use of other Congressional authorities, such as allowing the services to invest in non-government entities and convey excess land to private developers. These deals do not allow the land to be sold and are often 50-year arrangements that end with housing transferred back to the Navy and Marine Corps. (Cahlink, 2001)

There are several key features to the PPV according to the Navy-Marine Corps. These features include:

- Zero out-of-pocket expenses to the service member
- Military construction quality or better for the homes
- The elimination of the renovation/replacement backlog
- Guaranteed operation and maintenance resources for the long term
- Future renovations/replacements will be fully funded by this project
- Services reserve accounts are established to fund future unknowns

- The services participate in all key management decisions

By 2005, the Navy plans to complete sixteen PPV deals at eleven bases, with some bases having two or three different PPV deals to account for all of the privatized housing. The Navy plans to convey 8,669 adequate units to PPV by 2010. PPV renovates 5,144 inadequate units while MILCON renovates 13,657 units. New PPV construction will replace 3,739 demolished units while MILCON will replace 1,830 demolished units. PPV and MILCON will demolish and not replace 3,373 inadequate units at bases with excess capacity. By 2010, PPV will reduce the overall family housing deficit at underserved bases by 3,844 units through new construction, while MILCON reduces the family housing deficit by only 517 units. (Navy-FHMP, 2001)

While some Navy deals are for 30 to 50 years, with the housing reverting to Navy control at termination, some are also much shorter, with provisions to sell the property on the open real estate market. The shorter deals, which take place at smaller bases and encompass fewer units, are for ten to fifteen years and allow for the sale of individual units as early as the sixth year of operations. Current residents have purchase priority and may be offered reduced closing costs and relief from real estate commissions. When the deal reaches full term, the PPV liquidates the remaining units on the open market. Because it is a full business partner in the PPV, with a significant financial stake, the Navy receives a substantial portion of the liquidation proceeds. This process may be reinvested in another local PPV if a housing shortage still persists, or they may be invested in a PPV at a different Navy base with MFH shortages.

E. AIR FORCE

The Air Force plans to privatize a total of 32,900 units under 34 different projects. This represents 30% of its total housing inventory. With a total of 65,254 inadequate houses within the Air Force, it is believed that it would take at least 20 years at current funding levels for the housing to be revitalized using traditional MILCON methods.

The Air Force Center for Environmental Excellence (AFCEE) administers the MHPI for the Secretary of the Air Force through their Housing Privatization Office (HPO). The AFCEE-HPO describes its plan as a program that matches Air Force requirements to real estate market opportunities to provide the best value housing,

maximizing developer creativity and returning a transaction with a high potential for successful completion.

Under AFCEE-HPO's plan, private developers own the housing units, located on private land or on land leased from the Air Force. Air Force personnel receive BAH and pay rent to the private developer. Rents are less than the BAH rates with the difference accounting for a utility allowance. This is designed to eliminate out-of-pocket expenses for the average tenant. The developer manages and maintains the property for fifty years. Tenants pay for utilities directly without government or developer involvement. (AF-FHMP, 1999)

Although the Air Force believes MHPI is a key element to eliminating inadequate family housing, it intends to use traditional MILCON methods to accomplish most of its housing revitalization. Major General Earnest Robbins, who oversees the Air Force's MHPI program, admits that his service's more tentative approach to MHPI precludes it from meeting the DoD guidance to eliminate inadequate housing by 2010. He says the Air Force prefers a "balanced approach," preferring privatization only at bases located in strong commercial housing markets, and intending to reinvest savings from MHPI projects into other MILCON projects. Robust commercial markets ensure the Air Force and developer could easily obtain civilian tenants or sell the housing units if the Air Force no longer needs them. (Cahlink, 2001)

The Air Force uses three criteria to determine the appropriate investment strategy for revitalizing housing at each base. If all criteria are met, privatization is generally accepted. If any one of the three criteria is not met, the traditional MILCON option is generally accepted.

- Severability. The Air Force requires privatized housing to be physically separate from other installation functions. To be eligible for privatization, it must be possible, but not required, to place a fence around the housing area and to obtain access to the area from a public road. This ensures that if, at a later date, the demand for military families is insufficient to fill housing, alternate civilian renters could access the housing estate without entering the operational portion of the installation. (AF-FHMP, 1999)

- Economic Feasibility—Scored Cost. The privatization candidate must obtain the minimum three to one leverage ratio required by DoD policy. The scored cost, under the Office of Management and Budget (OMB) guidance, cannot exceed one-third of the estimated MILCON cost to complete a project of identical scope. (AF-FHMP, 1999).
- Economic Feasibility—Life Cycle Costs (LCC). The LCC associated with privatization must be less than the LCC for an identical MILCON project. The Air Force defines the MHPI LCC as the sum of the OMB scored costs and the net present value of the expected BAH paid to service members living in the privatized units. Government ownership LCC is the sum of the MILCON construction costs and the NPV of all estimated future costs for maintenance, repair, utility, management, and any other services provided over the life of the units. (AF-FHMP, 1999)

Only time will tell whether the Air Force's more limited approach to privatization is more successful than the Army's. The Army takes limited MILCON appropriations very seriously. Many of its projects assume no cash contribution from the Government. In Monterey, for example, Government land and housing represent the Army's entire equity in Monterey Bay Military Housing, LLC. In contrast, if a project does not meet the Air Force's three criteria for privatization, it opts to wait for MILCON funding for the project.

The Air Force may capitalize on the Army's success. If the Army modernizes its housing while minimizing use of MILCON appropriations, those appropriations may be available to the Air Force.

As we shall see in Chapter V, several environmental factors affect the economic feasibility of each project. Perhaps the most important factor is the health of the commercial housing market. In Monterey, for example, taking one's BAH and renting a house or apartment from a commercial landlord is a viable alternative, especially if BAH keeps pace with commercial rents. Conversely, since all the housing is accessible, renting to the public at prevailing commercial rates is also a viable alternative. Thus, if the Corporation were to produce substandard housing or if maintenance were sub par,

potential renters may choose not to live in it. The pressures of the commercial marketplace force the Corporation to build and maintain attractive communities.

However, the markets are very different in Fort Polk or Fort Irwin, where there are no viable alternatives to military family housing. The Air Force would probably choose not to privatize such sites. One of the Army's strategies for attracting corporate partners to such projects is to group them with other more attractive sites. For example, the Army grouped Fort Irwin with Park Reserve Forces Training Area and Moffett Field; and Picatinny Arsenal was grouped with Fort Monmouth and Carlisle Barracks. Privatization is more risky in these less commercially-viable locations.

F. CHAPTER SUMMARY

Although DoD maintains oversight and sets policy, the distinct approaches taken by the Air Force, Army and Navy/Marine Corps demonstrate the inherent flexibility built into the MHPI program and the services' long-standing tradition to differentiate themselves from one another. Each of the services recognized the MHPI as a unique opportunity to improve their long-standing housing problems and have taken aggressive steps to institute the program. Moreover, recent military studies indicate that high-quality housing can boost retention by up to 15%. The services realize that they enlist soldiers, sailors, airmen and marines; but they retain families.

IV. RCI AT MONTEREY

A. INTRODUCTION

Utilizing a strategy developed by the Army Assistant Chief of Staff for Installation Management and refined at Forts Hood, Lewis, and Meade, the Program Manager (PM) for RCI issued a Request for Qualification to all contractors interested in forming a limited liability corporation to build and manage more than one thousand family housing units on Navy land (La Mesa Village) and on Army land (Ord Military Community).

Applying Source Selection Procedures from contracting, a Source Selection Board reviewed the submissions and selected Clark Pinnacle as the most likely candidate. Clark Pinnacle then had approximately a month to submit a proposal for demolishing all the housing units and building entire new communities. Predictably, the proposal was not particularly good. Monterey's PM RCI and Clark Pinnacle then consolidated their efforts to develop a Community Development Management Plan (CDMP), a detailed plan for forming a limited liability corporation and for constructing and maintaining all the family housing on the Monterey Peninsula. The CDMP serves as the blueprint for RCI Monterey and as the basic submission to Congress. Congress approved Monterey's CDMP in 2003.

The basic problem with all military housing programs from 1949 to the present has been funding shortages. In the case of RCI Monterey, the corporation secured \$450 million in private financing by pledging military BAH and commercial rent. Privatization led to some curious work-arounds. Requiring service members to live in the corporation's houses is an indicator of government housing. The Office of Management and Budget cautions that such indicators of government housing jeopardize the private financing. So, the corporation cannot require service members to live in its housing.

Currently, approximately 68% of married service members on the Peninsula live in military housing—the highest percentage in the country. As a result of increased BAH and the requirement that all occupants of corporation housing assign their entire BAH to the corporation as rent, larger percentages of military personnel are expected to elect not

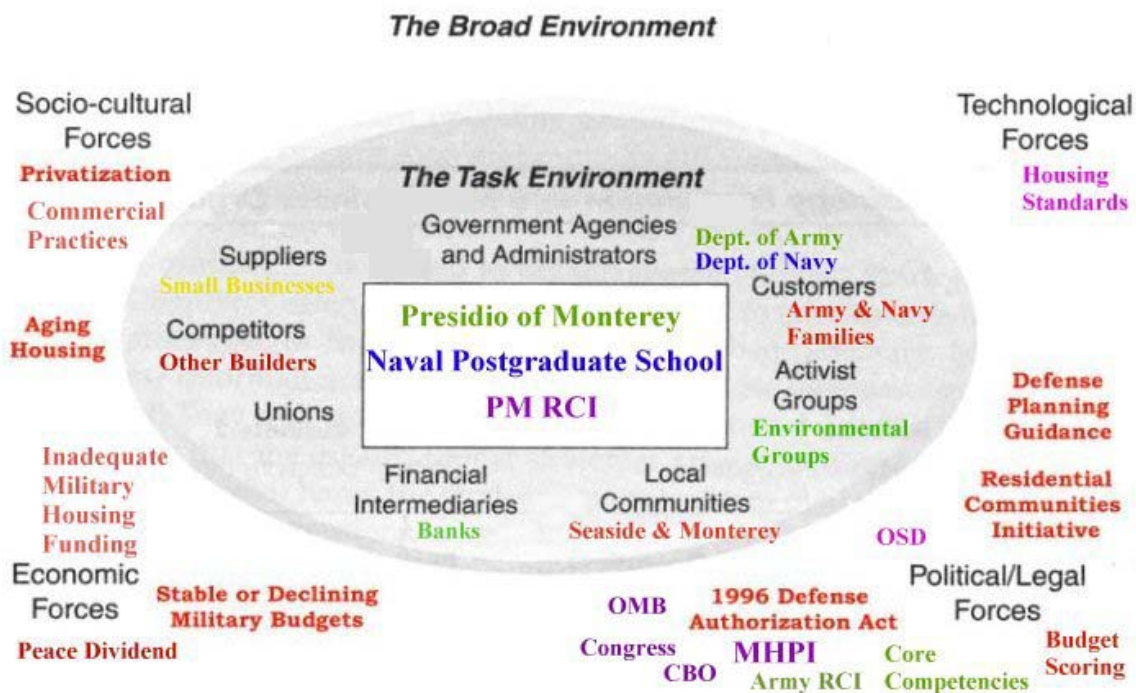
to live in corporation housing. That in turn leads to higher vacancy rates, jeopardizing the profitability of the corporation. In expectation of vacancies and to further bolster the private face of the project, civilians are expected to occupy some percentage of corporate housing. Service members will have the right of first refusal, and, if necessary, non-military renters will be moved out to accommodate service members.

Overall, 2,209 houses will be built on the Monterey Peninsula. Clark-Pinnacle began receiving BAH in October 2003—the same month it began to demolish older homes and assumed responsibility for government housing on the Peninsula.

B. STAKEHOLDER ANALYSIS

The Department of the Army (DA) sees external stakeholders as key to successfully implementing its Residential Communities Initiative and has forged strategic alliances with key stakeholders. The DA's initial plan, completed in September 1998,

Figure 4 - 1: Broad and Task Environments



Source: *Foundations in Strategic Management*, p.5.

called for the privatization of 85,000 Army Family Housing (AFH) units over ten years at 43 U.S. locations. Privatization would leverage private sector resources and “cost avoid” all or most of an estimated \$6 billion requirement.

The stakeholders depicted in Figure 4-1 can be considered change strategists, change implementers, and change recipients. The change strategists for Monterey consist of Congress, Department of the Army RCI office, and, to an extent, the local program director. The change implementers consist of the program office in Monterey and Clark-Pinnacle. The change recipients are the service members and their families. Each of them can become a roadblock to change if they are not convinced that this change in housing is a smart one. For the change recipients, their behavior will determine whether this change will be a success or not. The Army will not force the military families to live within this community so the families hold a great deal of power as the recipients of this change.

In September of 2002, Monterey Bay Military Housing, Limited Liability Corporation (MBMH LLC) held a meeting for any and all internal and external stakeholders of this housing project. The MBMH LLC targeted its stakeholders in the following ways (Collier, 2003):

- 1. Department of the Army RCI**

The Department of the Army RCI (DA RCI) is the lead office for the Army’s RCI project and a definite supporter. Because of their position, they have a vested interest in all of the 28 RCI projects within the Army. They also have influencing ability. One of the main issues concerns building codes. RCI Monterey is not using market standards for housing. Instead, DA RCI pushed down to the local office the standards to be used in all the buildings. This takes away from innovation on the side of the contractor.

DA RCI also trained the local RCI office on the CDMP. All the internal stakeholders were involved in this training. When problems arose during the development of the CDMP, DA RCI were the ones that usually received a call by the local office for help. Moreover, DA RCI is overall in charge of the entire program. They are very supportive of all the privatization sites and do what they can to help in every way. (Collier, 2003)

2. The Housing Construction/Property Management Industry

The RCI office selected civilian construction companies with a solid performance history for quality and timeliness. Housing industry finds privatization very attractive for several reasons. First and foremost is the high and continual demand for on-post housing and the long-term partnership with the government. Many of the issues that Clark Pinnacle brought to the attention of the local RCI office were worked out through the CDMP process. During the six-months of developing the CDMP, Clark Pinnacle and the RCI office worked hand in hand on the details of the plan. This included real estate appraisals, land surveys, building surveys, environmental assessments, and professional planning and design services. Obviously, civilian contractors play a vital role in RCI and support this initiative. Clark Pinnacle has worked and continues to work hand in hand in this partnership with the military. (Collier, 2003)

3. Service Members

As the recipients of the change, the service members and spouses provided input and recommendations that eventually got included in the CDMP. For the most part, the service members are supporters of this program. In talking with several of them, there are a few who do not like the arrangement, but the overwhelming majority loves the idea. One of the main concerns of the service members dealt with the floor plans and the amenity buildings. During this meeting, the service members reviewed several of these plans and actually recommended changes to them. These recommendations were approved to be included in the final floor plans. By listening to the service members, the MBMH LLC quickly gained the favor of the change recipients.

Other areas that concerned service members involved the allotment of the BAH to Clark-Pinnacle and the idea that civilians could possibly move into these new developments. While the concern associated with the BAH allotment was taken care of through information briefings on how the process would work, there is still some uneasiness about the thought of civilians living in the communities. On several occasions, the RCI office presented the privatization plan to the service members and ensured them that the military will always have the first opportunity to move into the

homes. However, if there are vacant homes, the contractor does have the right to rent the home to civilians for the going market rate. (Collier, 2003)

4. Congress/Local Governments

Even with the Department of Defense (DoD) Military Housing Privatization Initiative (MHPI) being implemented, adequate Congressional funding, on a continual basis, is vital. As stated earlier, Congress must approve a contractor's CDMP as the final "stamp of approval." Therefore, Congress plays a very important function in this process and fall into the mixed blessing category of stakeholders. As for local governments, the City of Seaside brought the most grief to this program. One of the areas of concern dealt with local taxes. The city government wanted to place a local tax on the development. The local RCI office had to go to state court to get this issue resolved. Other areas of concern dealt with land in general. The Seaside's city managers wanted more land turned over to the city. However, all of the land that is currently under Federal property will be utilized in this development. One of the ways the local RCI office dealt with the City of Seaside was through the use of Congressman Sam Farr's office. When the program manager could not reason with the city managers, he would have the Congressman's office to call the city to resolve the issue. This took place with several issues, another one of them being the environmental issues. Many of these issues were brought to rests through the use of Congressman Farr.

Another area where Congress plays a vital role is under the Base Realignment and Closure process. Within the next several years, Secretary Rumsfeld wants 20-30% of the current operating bases to be closed or realigned. If this takes place, it will be interesting to see what happens with the current housing at those locations where privatization took place, to include the housing on the Monterey Peninsula. According to the terms of the Army's RCI project at Fort Meade, the real estate group contributed an undisclosed amount of cash for the project but also takes on certain risks, to include the possibility of the base closing. (Chittum, 2003)

5. Local Communities/Businesses

Each installation conducted seminars for members of the community, to include local businesses, to discuss RCI. Local businesses main concern dealt with businesses opportunities that would be made available to them. Because of this concern, they were

at first non-supportive of this program. However, that quickly changed. As with most contracts within the military, a large portion of the contract with the prime contractor will be subcontracted out. This is also the case with privatized housing. Local businesses were pleased to hear that Clark-Pinnacle subcontracted nearly 70% of the work related to the privatization program to small businesses and/or other businesses that fall under similar socio economic realm. This work includes painting, carpeting, cleaning, and ground maintenance amongst others. With this great of percentage given to local businesses, the local businesses and workforce became very content with this plan. Monterey is not the only location that is making local businesses happy. This is a fairly normal procedure throughout the Army. For instance, at Fort Hood, 80% of the work so far has been subcontracted by Actus to small businesses in Killen, TX. (Chittum, 2003) By showing these statistics to local businesses, future programs should have no problems gaining the support of this stakeholder group.

C. SOURCE SELECTION PROCESS

1. Request for Qualifications

The Monterey RCI office followed the standard two-step RFQ procedure that was outlined in Chapter III. The Army RCI Program Manager, working through the Corps of Engineers, issued the RFQ for California. This RFQ covered bases and installations throughout California. Contractors interested in bidding on any of the locations were required to respond to the first step of this RFQ. Twenty-two contractors provided their qualifications in response to the RFQ. An evaluation board consisting of five members then reviewed these qualifications. The board members consisted of Army RCI personnel, the Monterey RCI PM, and a National Guard representative. The first step of the two-step RFQ process determines the competitive range for a group of sites using the five evaluation factors discussed in Chapter three. As a result of this first step, three contractors made it into the competitive range: Clark Pinnacle Family Communities LLC, J.A. Jones Community Development LLC, and Lend Lease Actus LLC.

The Monterey RCI PM invited these three contractors to present an oral proposal to the Monterey office. Each contractor was given a twenty-four hour period to make his or her presentations. Their presentations were centered on the four factors for step two of the RFQ discussed in Chapter three. After these presentations, the Monterey RCI office

awarded the contract to Clark Pinnacle Family Communities LLC on July 9th, 2002. The contract provided Clark Pinnacle \$350,000 to work with the Monterey RCI office in developing the Community Development Management Plan.

2. Community Development Management Plan

The Monterey RCI office personnel went through extensive CDMP training conducted by DA RCI personnel. This training included all of the key internal stakeholders. Once this training concluded, the Monterey RCI office and Clark Pinnacle began what would become a seven-month project of putting together the CDMP. By working through this process, both parties brought forth issues and were able to resolve them while growing a strong business relationship. Clark Pinnacle provided their vision in the proposal they submitted in step two of the RFQ. The Executive Advisory Board, the name given to the mix of Monterey RCI office personnel and Clark Pinnacle personnel took this vision and, over seven months, crafted a detailed business plan called the CDMP.

One of the key steps to the CDMP was the inclusion of external stakeholders' thoughts and concerns regarding this project. As discussed earlier in this chapter, the external stakeholders brought many new ideas that the RCI office and Clark Pinnacle included in the final CDMP.

Once the CDMP was finalized, the Monterey RCI PM staffed it through the Department of the Army and the Office of the Secretary of Defense to Congress. Congress approved the CDMP for Monterey Bay and the United States Army and Navy transferred responsibility of government housing over to Clark Pinnacle LLC on 1 October 2003.

D. MANAGING CHANGE

Change succeeds when an entire organization participates in the effort. (Jick, 2003) Professor Jick provides organizations a guide to implementing change he calls the Ten Commandments. These commandments serve as a guide to change implementers, the personnel responsible for shaping, enabling, orchestrating, and facilitating a successful change. Congress, the Office of the Secretary of Defense, and the Army's Assistant Chief of Staff for Installation Management are the change strategists. When the Army's Program Manager for RCI and the Presidio of Monterey/NPS, who in this case

represent the change implementers, decided to implement RCI at this location, a Program Executive Office (PM), led by the program manager Patrick Kelley, was placed in charge of the program and he quickly assembled a team. This Office is responsible for the implementation, and all program planning, policies and procedures for the transition of current Army and Navy Family Housing inventory, including maintenance and management responsibilities to a private sector developer. This highly complex process involves selection of a developer, formation of a public/private corporation, development of a comprehensive Community Development Management Plan, including a Development Plan, Financial Plan, and Transition Plan, which involves economic architectural and engineering analyses and reviews. (Collier, 2003) Following is a view of how the PM RCI implemented the change, using Jick's Ten Commandments as a model.

1. Analyze the Organization and Its Need for Change

We have already discussed the need for change in military housing in general and in Army housing specifically. Congress' action rendered most discussion moot. When the services were slow to implement the Congressional mandate while studying the issues, Congress prodded the services to get moving.

2. Create a Shared Vision and Common Direction

When Mr. Kelley began implementing RCI in Monterey, he created his own temporary vision and direction. As part of the transformation, a civilian contractor, Clark Pinnacle, Inc., was chosen to perform the construction and manage the property. Clark Pinnacle, Inc. and the PM then sat down together over a two to three week period to form a permanent vision statement and agree on a common direction. Additionally, after selection of Clark Pinnacle the Army and Clark Pinnacle worked together for six months to create the Community Development Management Plan that was submitted to Congress. A successful vision serves to guide behavior and aid an organization in achieving its goals. Additionally, the CDMP provides detailed direction for the entire program. The key to the success of this vision and Plan, however, was not in their crafting, but rather in the way they were presented to the community and the soldiers. The PM conducted several "town hall" meetings with the military members and their families as well as with members and businesses in the local community. At these

meetings, the PM, which also includes the base commander, explained the rationale behind the change and how it would affect all the stakeholders involved. Clearly, this change would translate into a better living environment for the military family. The PM also allowed and utilized the recommendations put forth by the audience in these meetings. By doing this, the PM incorporated the change recipients into the decision making process creating a sense of ownership. The PM successfully created a shared vision by effectively communicating to the military families and local authorities the benefits of the change and the positive or negative ramifications that would occur if change did or did not take place. (Collier, 2003)

3. Separate from the Past

This was perhaps the easiest task for Army RCI to accomplish. Fifty years' of failed housing programs and declining housing quality made separating from the past easy. Not all stakeholders are convinced that privatization is the best alternative, but all are convinced that the old policies were not working.

4. Create a Sense of Urgency

When the Army adopted RCI as the way to fix their housing problem, they established 2010 as the target year for completely integrating the program at 43 installations. Senior officials in the Army then decided that 2010 was not soon enough and ordered all the installations to have the program implemented by 2007. Senior officials, most notably President Bush and Secretary of Defense Rumsfeld, pushed this requirement down to the services because they understood the urgent need for housing. The middle managers, in this case the PM at each installation, also understood the need to move the timetable forward. The PM office in Monterey agreed with senior officials that the housing needed fixed sooner than later. They took the initiative and became the fifth installation in the Army to implement this program. Moreover, the Army deals with privatization in two ways: either tearing down old homes and building new ones or renovating the older homes. The PM in Monterey and senior military officials realized the need to replace, not renovate, the housing on Fort Ord, the Presidio, and LaMesa village. (Collier, 2003) Although senior officials created a sense of urgency in the Army, local officials created an even greater sense of urgency and communicated this with both the strategists and the recipients alike.

5. Support a Strong Leader Role

As shown earlier, the process of implementing such a drastic change is very complex and time consuming. Mr. Kelly, along with the installation commander, took it upon himself to lead Monterey through this change. Because of the size and complexity of the change, one person alone could not effectively lead this change. The PM and military officials effectively established leadership roles. Whereas the installation commander dealt more with communicating and leading the military members and their families, Mr. Kelly dealt more with planning the construction and creating an implementation plan with Clark Pinnacle, Inc. By understanding the need for a dual leadership role and effectively practicing it, the PM and the military were able to create a solid vision and motivate both the civilian contractor and the military families to embrace this change. As with anything, strong leadership can make or break an organization. Sometimes, as is the case with RCI in Monterey, that leadership role must be divided into parts in order to be effective.

6. Line Up Political Sponsorship

Since RCI evolved directly from Congressional direction, political sponsorship was already lined up. The history of RCI reminds us that Congressional support sometimes dissipates at an astonishing rate, leading us to suggest an addition to this Commandment. Instead of simply lining up political sponsorship, we suggest Line Up Political Sponsorship and manage it throughout the life of the program.

As noted earlier, the change recipients play a vital role in determining long-term success. The change strategists and implementers must gain broad-based support throughout the organization. One of the ways to do this is to develop relationships with and obtain support from the right people within the organization. In Monterey, those “right people” are the Superintendent at NPS and the Superintendent at the Defense Language Institute. The PM and the senior military officials gained the support of these two officers early in the process by demonstrating the benefits that RCI would have for their commands. It was also easy to start with these two officers because both were thought to be receptive of this change. Not only did they embrace the change, but they also made RCI a high priority at each installation. For example, the Superintendent at

NPS provided his Superintendent's Guest Lecture time to the PM office to brief all military families on the change process.

We should note that not everyone will embrace and support any change and RCI is no exception. However, the PM did gain the unanimous support of the military members and the support of key leaders, or "political sponsors," early in the process that facilitated others to follow.

7. Craft an Implementation Plan

The Monterey RCI PM and Clark Pinnacle collaborated on their Community Development Master Plan. This plan was discussed in detail earlier in this chapter.

8. Develop Enabling Structures

The basic enabling structure for the Army was already in place—the Army Chief of Staff for Installation Management (ACSIM). In turn, the ACSIM appointed Program Managers for each site to define and operate RCI. ACSIM also defined the basic strategy of soliciting for contractors. PM RCI then selected Clark Pinnacle as its partner, and the two formed a limited liability corporation.

9. Communicate, Involve People, and Be Honest

Change leaders should communicate openly, and should seek out the involvement and trust of people throughout their organization. (Jick, 2003) The PM and senior military officials in Monterey clearly followed this guiding principle of Jick's. From the outset, communication between all parties--the strategists, implementers and recipients--provided a sound relationship. By having the "town-hall" meetings with the military families and allowing their voices and ideas to be heard, the PM gained credibility and the trust of the families. By listening and incorporating the ideas of the families instead of directing change, the PM gained a better understanding of the needs of the families.

10. Reinforce and Institutionalize the Change

The CDMP has been constructed, submitted and approved. The PM and Clark Pinnacle have formed a corporation. Leases have been signed, BAH assigned, and financing secured. These structures and mechanisms are difficult to reverse. Whether the program continues and succeeds remains to be seen.

E. CHAPTER SUMMARY

Service members living on the Monterey Peninsula are going to reap the benefits of the Residential Communities Initiative for years to come. The Monterey Bay Military Housing Limited Liability Corporation composed of Clark Pinnacle and the United States Government underwent a successful transition of government housing to privatized housing. The Monterey RCI office managed the change properly and acted upon both internal and external stakeholders' concerns. The Source Selection Process and the development of the CDMP went fairly smoothly. One area that Mr. Kelley would have improved is in the knowledge of the local governments. As part of the local RCI office, he believes a better understanding of the local governments could have been accomplished if a local official was part of the integrated team. Either way, the Monterey RCI office did a commendable job in the transition of housing from Government owned and operated to privately owned and operated.

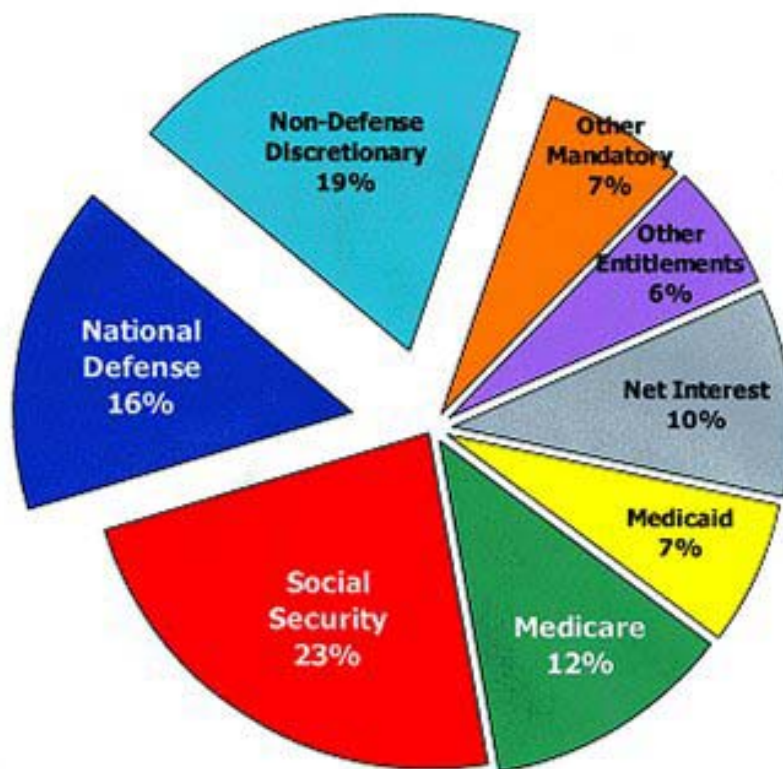
V. ANALYSIS OF RCI

A. INTRODUCTION: MILITARY HOUSING IN THE FEDERAL BUDGET

We still have a funding shortage for military housing. That has not changed since DoD assumed responsibility for housing its military families in 1948 or since DoD decided that housing is not a core competency in 1992. (Spigelmyer, 2003)

As the following chart illustrates, barring significant changes to mandatory programs and entitlements, increasing the relative size of the Defense budget to fund the Army's \$7 billion shortfall, means decreasing the non-defense discretionary budget—the budget that was expected to increase with the end of the Cold War. Deficit spending

Figure 5 - 1: The Federal Budget



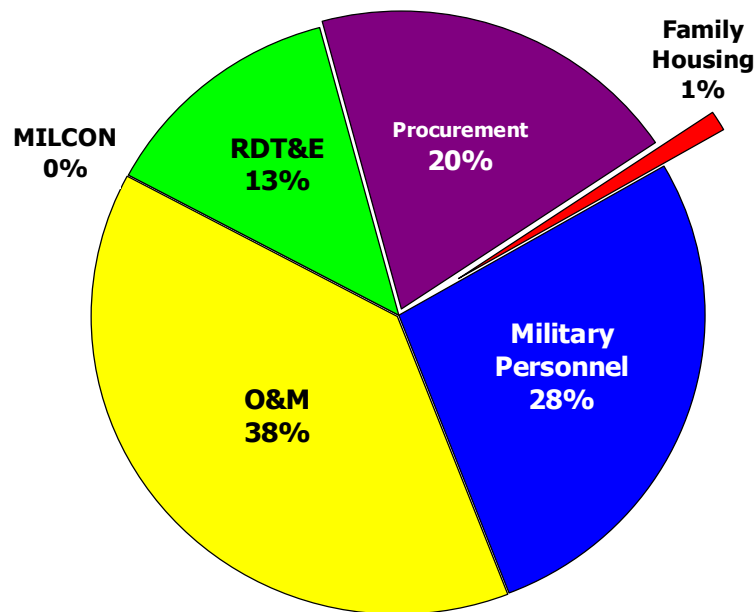
Source: McCaffrey & Jones, Budgeting and Financial Management in the Federal Government, p.10.

changes the relative proportions of the budget. Defense may benefit from deficit spending in one on more years, but deficit spending increases the relative size of the Net

Interest wedge, requiring a parallel decrease in one or more other wedges or more deficit spending. Since neither mandatory appropriations nor other entitlements are likely to decrease, the decreases must come from either National Defense or Non-Defense Discretionary or both.

The Congressional Budget Office projects that entitlements and mandatory programs will consume increasing proportions of the federal budget. In 1990 they amounted to 60% of federal outlays. They are projected to reach 74% by 2010. “. . . federal agencies will continue to fight for a dwindling slice of discretionary dollars and, as the slice of defense spending declines, the battle carries over to an internal struggle within DoD.” (LtCol Warren M. Anderson, USAF, LTC John J. McGuiness, USA, and CDR John S. Spicer, USN; “And the Survey says. . .the Effectiveness of DoD Outsourcing and Privatization Efforts,” *Acquisition Review Quarterly*, Spring 2002.)

Figure 5 - 2: Military Family Housing as a Percentage of the Defense Budget



Source: [www.defenselink.mil/news/Feb1999/b\)2011999bt032-99.htm](http://www.defenselink.mil/news/Feb1999/b)2011999bt032-99.htm)

Furthermore, recent tax cuts do not decrease mandatory programs or entitlements. Balancing the budget after a tax cut requires reductions in National Defense or

Discretionary Domestic programs or increases in the deficit. Thus, decreases in the Defense budget are likely.

Further, given the pressure to decrease the Defense budget, the competition between the services and within each service for funding increases. The small proportion of funding for military family housing, illustrated above, is more likely to shrink than to expand because the services routinely opt for weapon systems over housing.

Recognizing the unlikelihood of funding to meet housing shortages, an Army Tiger Team, including the current Army RCI Program Manager, recommended alternative approaches for funding military housing to Congress. These alternatives became the Military Housing Privatization Initiative (MHPI) in the National Defense Authorization Act of 1996. (Spigelmyer, 2003)

B. BUDGET SCORING

The twelve MHPI authorities—the twelve tools in the privatization toolbox-- form the basis for each service's privatization program. But the tools in the MHPI toolbox are not equally useful. The Office of Management and Budget associates a budget "score" with each of twelve authorities in accordance with the Omnibus Budget Reconciliation Act of 1990 [P.L. 101-508]. These budget scores, listed in Table 5-1, estimate impacts on the current year's budget. For example, conveyance or lease of Government land or housing units, building to local codes, building support facilities, and payment of rent by allotment all have budget scores of 0%. None of these affects the current year's budget.

Under this scheme Government land provided as the Government's equity in a public-private partnership or corporation is valueless. In contrast, investing Government funds in a joint venture, guaranteeing rentals, and requiring service members to occupy new housing have budget scores approaching 100% of the value of the investment, rentals, and BAH. Such oddities suggest that OMB and Congress are likely to reconsider the budget scoring, especially those scores that value the Government's real property at \$0. (Else, 2001)

Table 5-1 Alternative Authorizations, Ranked by Impact on Budget (Else, 2001)

Authority	Description	Benefit	Budget Scoring^a	Where Used^b
<i>Conveyance or Lease of Land or Units</i>	Transfer of ownership	Secure private financing immediate cash flow	None - 0% of land value ^c	Lackland (AF) Ft. Carson (A) Robins (AF) Camp Pendleton I (NMC) Kingsville II (NMC) Elmendorf (AF)
<i>Unit Size & Type</i>	Build to local codes	locally compatible, cost-effective construction	None	Lackland (AF) Ft. Carson (A) Everett I (NMC) Corpus Christi (NMC)
<i>Ancillary Support Facilities</i>	Permit supporting amenities	Enhance project attractiveness	None	Lackland (AF) Ft. Carson (A) Everett I (NMC) Corpus Christi (NMC)
<i>Payment by Allotment</i>	Guaranteed cash stream	Minimize rent payment uncertainty	None	Lackland (AF) Ft. Carson (A)
<i>Loan Guarantees</i>	Guarantee of private sector loan	Lower interest rate, ensure financing	Low - 4% - 7% of loan amount ^d	Lackland (AF) Ft. Carson (A) Robins (AF) Elmendorf (AF)
<i>Direct Loan</i>	Direct loan to contractor	Below-market financing	Moderate - 30% - 70% of loan amount ^e	Lackland (AF) Robins (AF) Dyess (AF) Camp Pendleton I (NMC) Kingsville II (NMC) Elmendorf (AF)
<i>Differential Lease Payments (DLP)</i>	Pay difference between BAH and market rents	Leverages private financing	Moderate to High - NPV of DLP over contract life	Everett I (NMC) Everett II (NMC) Corpus Christi (NMC)
<i>Investment (Joint Venture)</i>	Equity investment	Partnership interest	Moderate to High - 100% of cash equity	Everett I (NMC) Everett II (NMC) Corpus Christi (NMC) Kingsville II (NMC)
<i>Interim Leases</i>	Government lease of other units until project conveyed	Enables immediate occupancy	Moderate to High - NPV of lease payments during interim	
<i>Assignment of Members (Tenant Guarantee)</i>	Members assigned housing in project	Forces above market occupancy rate	High - NPV of BAH	
<i>Build to Lease</i>	Contract construction, lease units	Central payment by DOD (\$81-like)	High - NPV lease payments	
<i>Rental Guarantee</i>	Guarantee of occupancy or rental income	Enhances financing (\$82-like)	High - NPV rental payments	

a. Scoring in accordance with the Credit Reform Act and Budget Enforcement Act of 1990 (both part of the Omnibus Budget Reconciliation Act of 1990 [PL 101-508]), OMB Circular A-11, and OMB MHP1 Guidelines of June 25, 1991.

b. Project parent Service indicated by letters: AF=Air Force, NMC=Navy/Marine Corps, A=Army.

c. Because base land usually produces no revenue streams, and thereby has no impact on budget surpluses and deficits, "pay-as-you-go" provisions of the Budget Enforcement Act require that it be scored at 0%.

d. Scores for private source loan guarantees are calculated based on the degree of "exposure," or probability of default by the project's contractor under severely constrained conditions such as base closure.

e. Scores for DOD direct loans are calculated using the difference between the interest rate negotiated between the Service and contractor weighted by the probability of contractor default.

Both OSD's Office of Competitive Sourcing and Privatization and the Army's PM for RCI report that budget scores are important, even definitive, when considering which of the tools in the toolkit a service will use to repair or replace military family housing. (Helwig & Spigelmyer, 2003) For example, in Monterey the RCI PM offered the land and buildings in the Army's Ord Military Community and the Navy's La Mesa Village as equity for its 49% share in a public-private corporation, eventually called the Monterey Bay Military Housing LLC. (Collier, 2003) Monterey's combination of Army and Navy land and housing is the first joint-service housing initiative under MHPI.

Although land is at a premium in and around Monterey, contributing the land and housing at Ord Military Community, La Mesa Village, and Presidio of Monterey will have no impact on the defense budget. Because of budget scoring, DoD's real property has no budgetary value. In contrast, had the Army and Navy pledged the cash value of the land and housing for their share in the corporation, the entire cash amount would have been counted as an expenditure in the year the pledge was made. This would have required a Congressional appropriation. (Else)

Not surprisingly, the new housing planned for Monterey uses the following three of the four authorities with 0% budget scores: (1) The Army and the Navy made their land and existing housing available to Monterey Bay Military Housing, LLC for the new housing. All the existing housing will eventually be demolished and replaced. (2) The Monterey developments will also include ancillary facilities--infrastructure, community centers, community swimming pools, etc. And (3) rent will be paid through allotment of BAH. In effect, using the "free" MHPI authorities, Monterey's RCI PM leveraged the Army's and Navy's land, housing, and future BAH to purchase 49% of a limited liability corporation which then borrowed \$450 million from private lenders to finance the new housing in Monterey and Seaside, California. The expected BAH and commercial rents represent the cash flow that justifies the loan. (Collier, 2003)

1. Building Codes

Initially, the Army intended to build to local codes, in accordance with the other MHPI initiative with a 0% budget score. That policy has recently changed with the publication of Army-wide standards for family housing. (Spigelmeier) Those standards are available on the Army's RCI website. Army RCI and the local RCI PMs apply the

Army-wide standards in conjunction with local standards. Local building codes vary, but the Army's standards are generally more stringent than local ones. For Monterey, the Army's standards are stricter than local codes. Use of stricter building standards certainly drives up building costs, but higher quality constructions may justify the increased cost. Predictably, conflicts among the Army's standards and between the Army's standards and local ones lead to considerable negotiation between the Army and its corporate partners. Such conflicts may also lead to delays in receiving permits and approvals from local authorities. (Collier, 2003)

2. Real Property as Corporate Equity

The Corporation started fiscal year 2004 with the transfer of 2268 units, 1,675 from the Army and 593 from the Navy. It will demolish and not replace a 50-unit apartment building on the Presidio. The Defense Language Institute will use the land for instructional purposes. Eventually, as the units at La Mesa Village are demolished and replaced, they will be spread out a bit, yielding nine fewer units. After construction is complete, the Corporation will own and manage 2209 units. Importantly, demolition and construction will proceed gradually over the next eight years. As a result, the new military housing communities will take shape slowly through 2012.

Table 2 and the two maps, following, indicate the order of construction.

Table 5-2 Monterey RCI Construction Schedule

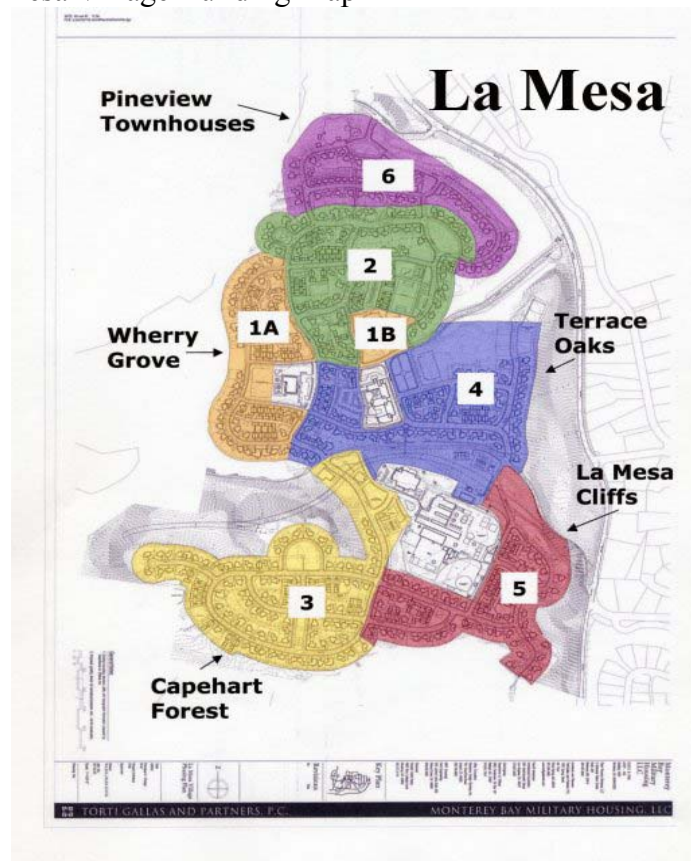
Construction Begins	Neighborhood
1st quarter 2004	Ord - Hayes Park
1st quarter 2004	La Mesa - Wherry Grove
2nd quarter 2005	Ord - Fitch Park
1st quarter 2006	La Mesa - Wherry Grove
3rd quarter 2006	Ord - Fitch Park
2nd quarter 2007	La Mesa - Terrace Oaks
4th quarter 2007	Ord - Upper Stillwell Park
2nd quarter 2008	La Mesa - Capehart Forest/La Mesa Cliffs
4th quarter 2008	Ord - Marshall Park
2nd quarter 2009	La Mesa - Pineview Townhomes
4th quarter 2009	Ord - Marshall Park
4th quarter 2010	Ord - Lower Stilwell Park
4th quarter 2011	Ord - Lower Stilwell Park
3rd quarter 2012	Ord - Lower Stilwell Park
Authors, based on data from the Monterey RCI website	

Figure 5 - 3: OMC Building Map



Source: From Monterey RCI website

Figure 5 - 4: La Mesa Village Building Map



Source: From Monterey RCI website

C. THE ECONOMICS OF RCI

1. Incentives for Builders and Property Managers

If the entire amount of BAH went for construction, property management, and servicing the debt, then the private-sector firms would have little incentive to participate in RCI's public-private corporations. Exact fee structures for RCI projects are proprietary, but the Army RCI website contains general guidance on the fees private companies can expect to collect for participation in RCI Corporations. A copy of that guidance is in Appendix C. A summary of that general guidance follows:

Property/Asset Management:	3% - 5% of gross rent for available units less vacant units
Development Management:	3% - 5% of total projected development costs
Construction Management:	3% to 6% of projected total "hard" cost of construction
Other fees:	None
Return on Invested Equity:	Minimal, based only on at-risk equity

The Government and the contractor negotiate exact fees, including the automatic and incentive proportions, during development of the CDMP. The Army's guidance suggests that a "material proportion" of Property/Asset Management and Construction Management Fees should be performance-based and that the entire Development Management Fee should be "at risk" if the developer fails to meet milestones. Projected costs are determined during development of the CDMP. They are not actual costs.

Appendix C also contains a description of how the Corporation will determine the incentive fee portion of the Property Management Fee at Fort Meade. The overall Property Management Fee at Fort Meade is 5%; 2% (2/5 of the total fee) is the maximum incentive Picerne, Fort Meade's corporate partner, can earn. Award of the incentive proportion is based on customer service, maintenance response, occupancy, budget, and quality of life, weighted equally.

See also paragraph I4: Cost plus Percentage of Cost, below for a discussion of some of the dangers and unintended consequences of basing a contractor's fee on the actual or projected costs of a project.

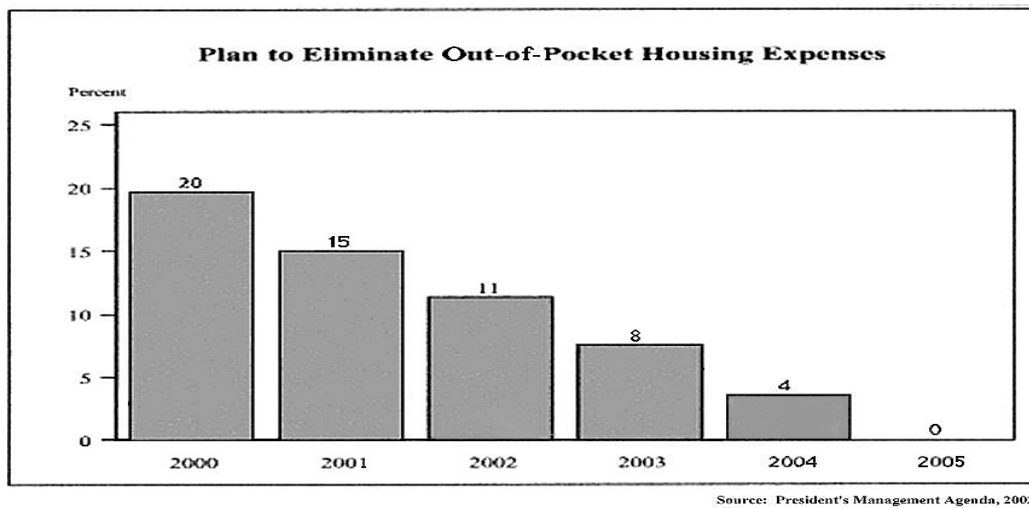
2. Basic Housing Allowance

In some high-cost locations, like Monterey, California, service members found that market forces had driven up the cost of housing so that rental costs exceeded BAH. To offset the difference in BAH and commercial rents, the Army and Navy provided affordable housing for service members and their families. Essentially the Army and Navy offered service members the choice of Government housing with no BAH or full BAH which service members could apply to housing in the commercial rental market. Sixty-eight percent of the service members at the Naval Postgraduate School and the Defense Language Institute chose to live in La Mesa or the Ord Military Community. Evidence of long waiting lists at the Monterey military housing office indicates that the percentage might have been higher had more housing units been available. Brad Collier, Deputy Program Manager for Monterey's RCI office, reports that a Housing Needs Assessment of the Monterey Area indicates the need for more than 2,209 units but that DoD's land will support no more housing units. (Collier, 10/29)

Increasing BAH to eliminate out-of-pocket housing expenses should change the equation considerably. In his President's Management Agenda for FY2002, President Bush reiterated his commitment to reducing average out-of-pocket expenses for housing to zero by 2005. "This will enable more military families to leave inadequate government housing and rent quality private-sector housing in the local communities around DoD installations." Figure 5-3 shows the progression to zero percent average out-of-pocket expenses for service members.

Service members' choices may change as BAH approaches and equals commercial rents in the area. Under RCI agreement, service members can choose whether to live in Corporation (military) or private-sector housing. If a significant proportion of potential renters choose to rent private-sector housing, the Corporation's financial projections may require rethinking. This is especially true during the eight-year building period when existing housing, which costs the same BAH as the new housing, may appear especially cramped and unattractive.

Figure 5 - 5: President's Plan to Eliminate Out-of-Pocket Expenses



More than any other single factor, this ability to choose disciplines the Corporation's practices. If the Corporation does not build and maintain nice neighborhoods, potential military and civilian renters may choose to spend their housing dollars with private-sector landlords.

But rental housing is in short supply around Monterey, and the Corporation has agreed to fill all vacant housing—housing not occupied by military families—with civilian renters, typically at open market rates.

3. The Economics of Location

The economics of each agreement, and each Corporation or partnership, depends on the local housing market around each location. Around Forts Irwin and Polk there is little private-sector housing available for military families. There is also little commercial competition with new military family housing. BAH for Fort Irwin is less than for Monterey. Property values in and around Fort Irwin are lower than around Monterey, and units constructed for Fort Irwin will command lower rents than those in Monterey. If competition with the private sector is a major motivating factor for the Army's public-private partnerships, finding adequate motivation for those sites where there is no competition will challenge Army RCI.

Further, the feasibility of civilian occupation of vacant housing may depend on whether that housing is inside the fence of a closed installation. In Monterey, all the new housing, except for historic houses at the Naval Postgraduate School and the Presidio, is accessible to the public. At Fort Meade, for example, the new housing is inside the fence. In short, the economics of individual projects will certainly be different from Monterey's. Land and existing housing alone may provide insufficient equity to attract corporate partners at Fort Irwin, Fort Polk, etc.

To increase the attractiveness of some smaller or more isolated sites, the Army packaged them with other sites. For example, Fort Irwin alone might not attract potential corporate partners. So, the Army "packaged" Fort Irwin, Parks Reserve Forces Training Area, and Moffett Federal Airfield.

4. Return on Investment

Rental housing differs from other commodities in the time required to earn a return on investment. Commonly in the U.S., homebuilders finance the costs of a commercial housing development, selling their houses to buyers, most of whom obtain thirty-year mortgages. But in the case of the Army's projects, neither the residents nor the Government will buy the newly constructed housing. It is not unreasonable, therefore, that property owners might require twenty-five or fifty-years to recover the costs of construction, service the debt, and repay the principal.

5. Corporate Income and Expenses

Although the existing housing in Monterey is deteriorating and will be demolished and replaced in the next eight years, its contribution to the Corporation is not trivial. Specific cost and income data is proprietary, but we can make some educated guesses about the shape of the Corporation's financing. If we assume that average BAH for the Monterey area is \$2000 per month, then the Corporation gains \$2000 per month for every rented unit. 2200 units @ \$2000 each = \$4.4 million in income per month. Of course, that amount must be adjusted for uninhabitable units and for those under construction at any time.

Depending on the speed of demolition and construction, it appears that 200 to 300 units will be under construction at any time. For example, initial construction in La Mesa begins with the vacant land in the Wherry Grove neighborhood. Subtracting 200 or 300

from 2276, depending on when the Corporation demolishes the apartment building on the Presidio, for example, leaves approximately 1900 to 2000 revenue-producing units throughout the construction period. 1900 units @ \$2000/unit/month = \$3.8 million/month or \$45.6 million/year. 2000 units @ \$2000/unit/month = \$4 million per month or \$48 million/year. Stretching our construction for eight years makes good economic sense.

We are not experts in corporate finance or housing industry costs. But we know that servicing a \$450 million debt would consume a considerable proportion of the Corporation's income, depending on how much of that loan is outstanding at any given time. Considering, for example that the Corporation collects \$3.8 to \$4 million per month and intends to construct 200 to 300 housing in the coming year, it does not seem likely that the Corporation will borrow the entire \$450 million and paying interest on it.

Maintaining the existing aging units through the construction period will also increase the Corporation's costs. Based on its construction schedule, the Corporation can easily calculate how much rent a unit will yield and therefore, which expenses to incur, which to defer, and which to avoid altogether.

D. TRADING BAH FOR MILCON

Congress would not appropriate \$450 million per year for new housing in Monterey, but it is willing to pay considerably more than \$50 million per year in BAH indefinitely. If 68% of the military personnel assigned to the Naval Postgraduate School and the Defense Language Institute live in 2268 military family housing units, then approximately 3385 military personnel are eligible for BAH and military housing. At \$2000 each, total BAH for the area is more than \$80 million per year. The Corporation stands to collect \$50 million per year, which it will use to repay the financed cost of new housing in Monterey and other expenses in Monterey. The Army RCI PM commented that \$450 million exceeds the Army's entire family housing appropriation for FY04 and that little or no savings will result from shifting the funding from MILCON appropriation to BAH. (Spigelmeyr, 2003)

E. RELATIVE "PRIVATENESS"

The relative "privateness" of the Army's projects is under constant scrutiny. The Monterey Bay Military Housing Corporation, LLC, borrowed \$450 million from a

private lender, pledging BAH and commercial rents to repay the loans. Since agencies of the federal Government cannot routinely seek private financing, the Corporation must be seen as something other than an agency of the federal Government. OSD reports that OMB's view is split, that Congress is more or less ambivalent, and that the Congressional Budget Office is opposed to the Army's public-private organizations. (Helwig, 2003)

Thus, OSD cringes when Army officials speak of "firing" an under performing contractor. Partners do not "fire" partners. And corporate stockholders do not "fire" other stockholders. Similarly, waiving property taxes on a project because the local taxing authority views a public-private venture as a Governmental entity would jeopardize the corporation's "privateness."

It would be unfortunate if a misunderstanding jeopardized the "privateness" of Monterey's project. When Monterey RCI personnel speak of firing a construction company or a property management company, they are not speaking of firing a corporate partner. Monterey Bay Military Housing, LLC contracted with Clark Construction to demolish and construct the new housing at La Mesa and Fort Ord and with Pinnacle Properties to manage existing and new construction. When RCI personnel speak of firing a company, they are referring to the companies with whom the Corporation has contracted. (Collier, 2003)

In case any doubts linger, the relationship between the owners of the Corporation is not a contractual one. The only contracts in this relationship are (1) the \$350,000 contract the Army awarded to Clark-Pinnacle to prepare the Community Development Management Plan (CDMP) and (2) the contracts the Corporation issued to Clark Construction for building housing and amenities and to Pinnacle for managing that property. Theoretically, either of these last contracts could be ended for cause. However, Government contract law does not govern the relationship

F. THE TREND TOWARD PRIVATIZATION

The trend in Government over the last twenty years has been to privatize functions that are not core competencies. The Government seeks commercial sources for activities which are not considered inherently Governmental. As previously stated, the Department of Defense decided in 1992 that military housing is not a core competency (Spigelmeyr, 2003), opening the way to privatization.

A public corporation for military housing was considered in the early '90s. Such a corporation would have incorporated local housing offices into a public corporation, which could then have been funded with BAH. Probably special legislation would have been required for such a corporation, and it is doubtful whether such a public corporation could have leveraged private financing to accomplish its goals.

A public corporation would have amounted to a half-measure since DoD had already decided that housing was not a core competency. And a public corporation would simply have institutionalized (incorporated) a housing program that was already failing. Instead, DoD, with Army as the lead, decided to tap the expertise of the commercial marketplace and avail itself of the advantages of competition, neither of which would necessarily have been accomplished by a public corporation. These decisions then formed the basis for MHPI, with each service allowed the freedom to apply them in service-unique ways.

G. COMMERCIAL PRACTICES

Paralleling the trend toward privatization is the movement toward commercial practices in Government acquisition. As the number of Government contractors shrink and as the commercial marketplace replaces the Government as the primary source for technological innovation, pressure builds to reduce unique Governmental requirements and restrictions in favor of commercial practices.

Commercial and industry specifications have replaced military and government-unique specifications and standards. The Army's decision to use Army-wide construction standards instead of relying on local building codes runs counter to this trend. We are encouraged to use performance specifications instead of DoD's traditional detailed specifications to use the creativity of the marketplace. Replacing traditional statements of work with simpler and broader statements of objectives also maximizes reliance on the expertise and creativity of the commercial marketplace. Nowhere is the change more profound than in relationships between the Government and its contractors. Rather than the suspicious, arms-length relationships that characterized Government-contractor relationships, we are encouraged to treat our contractors as partners in continuing mutually profitable relationships.

In this commercial-partner context, the Army's public-private limited-liability corporations and limited-liability partnership can be considered a major step toward applying commercial practices to military housing. Commercial corporations commonly form joint ventures, and now the Army joins with private companies to form corporations (a partnership at Fort Hood) to privatize and modernize Army family housing.

H. JACQUES GANSLER ON MARKET-BASED GOVERNMENT

It is easy to be fooled into believing that RCI's two-step process is about acquiring housing. The process includes an RFQ. It evaluates responses using source selection procedures. The second step uses oral proposals and results in a contract to develop a business plan (the CDMP). Developing the CDMP looks very much like Alpha contracting. This selection process is more accurately about selecting a partner for a corporation that will build housing. One could reasonably argue that the two-step process is not an acquisition at all; it is an elaborate application process followed by a job interview. The process certainly weeds out unqualified applicants, and it probably results in selection of the best-qualified applicant.

After Congress approved the joint Government/developer CDMP, the Army and Clark-Pinnacle Family Communities, LLC, formed a corporation whose goal is to build and maintain housing. The Corporation then contracted with Clark Construction for demolition of existing housing and construction of new housing and with Pinnacle Realty Management for management of the existing and new properties. The Army PM for RCI and Monterey's Deputy PM for RCI say that the Corporation (Monterey Bay Military Housing, LLC, in Monterey) can fire the construction company (Clark, in Monterey) or the property management company (Pinnacle, in Monterey). (Spigelmyer, 2003 & Collier, 2003) It is less clear whether selection of Clark Construction to build new houses and Pinnacle Management to manage the housing was a necessary outcome of the two-step selection. If not, then these are sole source commercial contracts. Since the Corporation—a commercial entity--issued these contracts, they are not covered by the FAR.

From the point-of-view of Government contracting, the arrangement is very confusing. To assist a Government unfamiliar with the rules of the commercial marketplace Jacques Gansler outlined some broad guidelines for privatization in "Moving

Toward Market-Based Government: The Changing Role of Government as the Provider.” In this analysis we are somewhat handicapped by RCI’s determination that CDMPs, including Monterey’s, are proprietary, preventing access to them.

Prof. Gansler’s Four Principles of Program Delivery can assist us in our move toward privatization and commercial practices. The next several sections consider how these principles apply to the Army’s RCI program. The four principles are:

1. The key to success is shifting from a monopoly to a competitive environment;
2. The competition must be run for “best value” rather than simply for low cost;
3. Even when the Government contracts out work to be performed, it does not give up any of the control or management responsibilities;
4. There is a critical need for detailed metrics.

Since RCI is not essentially a Government contracting effort, we must translate such terms as “best value” to corporate behavior in a commercial marketplace. If there were a contract between the Government and Clark-Pinnacle to build and maintain housing, we might, for example, look in Section E for quality assurance provisions and metrics. This is no such contract. Unfortunately, since the RCI PM would not allow access to the CDMP, we could not determine if that document contains any QA metrics.

1. Shifting from Monopoly to Competition

“The key to success is shifting from a monopoly to a competitive environment. Simply shifting from a Government workforce to a private sector one while still in a monopoly environment does not create the incentives required to achieve the potential performance gains and cost reductions that competitive environment offers. Similarly, after an initial competitive award is made—either to the public sector workers or to the private sector—it is essential that the potential for future competition (in a few years) still be maintained. . . . *It is the presence of competition (or even the clear potential for it) that forces the performer to innovate for higher performance at lower cost.*”

Prof. Gansler’s first principle refers to state-run monopolies, e.g., Washington, DC’s Metro system or San Francisco’s BART—a situation in which the Government provides a service and prevents others from competing. Had the federal Government simply contracted out the U.S. Postal Service without relaxing the statutes and regulations that prevent competition, we would have traded a Government-run monopoly

for a private one. Nothing, except loss of volume, would have prevented the private replacement from raising its rates or providing poor service.

Had the Government *competitively* contracted out the Postal Service without relaxing the statutes that regulate future competition we would be only a little better off. We might feel confident that we had awarded to the “best value” offeror, but we would still be at the mercy of a private monopoly.

Instead, the Postal service was converted to a public corporation *and* the statutes and regulations that limited competition were relaxed. So, if the Postal Service raises its rates for overnight mail, the consumer can opt for FedEx or UPS. Both the presence of competition and the presence, or at least the threat, of *continuing* competition “. . . forces all performers to innovate for higher performance at lower cost.”

a. Does RCI Eliminate or Reduce a Monopoly?

None of the installations considered under OSD’s MHPI or the Army’s RCI require service members to live in military housing. Military family housing may constitute a niche market, but there are usually competitors for service members’ housing dollars. In Hawaii; Monterey, California; Fort Belvoir, Virginia; and Fort Monmouth, New Jersey, military housing is not a monopoly. Each of these locations offers private-sector alternatives to military family housing. Assuming that BAH is adequate for private-sector rents, service members can choose between military neighborhoods and a variety of private-sector ones. In such cases RCI neither increases nor decreases chances of a monopoly.

In more isolated locations, whether military housing is a monopoly is less clear. Fort Meade, Maryland is located between Washington, DC and Baltimore, Maryland. There is little private-sector housing in the immediate vicinity of the Fort, but within thirty minutes to an hour’s drive are Baltimore, Washington, and their suburbs’ virtually unlimited private-sector markets. Clearly, Fort Meade military housing is not a monopoly, but competition there is imperfect. RCI neither increases nor decreases private-sector competition in locations like Fort Meade.

Forts Irwin and Polk are more clearly monopolistic. While service members are not required to live on post, the posts are hardly surrounded by private-sector rental housing. There are few or no private-sector alternatives. Additionally, there

are considerable blocks to entry into these housing markets. Given the possibilities of base closure or reductions in force, builders are generally unwilling to accept the risks of developing private-sector housing around isolated bases. While RCI's increasing the numbers and quality of on-post housing may effectively reduce the demand for off-post housing; on balance, RCI neither increases nor decreases competition at isolated locations.

b. Does RCI Increase Competition or the Threat of Competition?

Just as RCI does not reduce the occurrence of monopoly in military housing, it also does not increase competition. Further, where one of RCI's public-private partnerships or corporations simply replaces a housing office, it does not increase the *threat* of competition. RCI argues that the threat of competition among builders and property managers will keep costs down and quality high. From a potential renter's point-of-view, the organization that provides housing is the same. Its quality or responsiveness may fluctuate, but it is still Monterey Bay Military Housing, LLC, for example.

The choices are not so clear-cut at other RCI sites. At Fort Irwin, there is no commercial housing available outside the gates of the fort. As a result, military housing is a virtual monopoly there. Per Prof. Gansler, replacing a monopolistic military housing office with a monopolistic contractor, even if the initial solicitation is competitive, leaves little incentive to achieve the performance gains and cost reductions associated with the competitive marketplace. We do not have the details about the agreements at Fort Irwin; but if those agreements mirror the agreements at other Army sites, there is little promise of future competition.

c. Could RCI threaten continuing competition?

As long as RCI simply replaces local housing offices with a public-private organization, it neither increases nor decreases competition. Increasing competition at both the prime and major subcontractor levels would benefit consumers. The Army might, for example, borrow an idea from the Air Force and contract for preferential access to private-sector housing in return for Army land. In locations like Fort Polk and Fort Irwin, "free" land would increase the incentives for private developers to build private-sector housing. The preferential access might guarantee the Army the right of

first refusal on the new housing units. Other incentives, like guaranteed loans and guaranteed tenancy, are possible but would be more expensive for Army RCI.

Even if increasing competition at the “prime” contractor level is not feasible, competition at the subcontractor (builder and property manager) level would still offer clear advantages. Commonly large housing developments use multiple builders, which increase the variety of housing and distribute the risk. In Monterey, for example, might multiple builders have increased the speed with which new housing is constructed? When there is only one builder, the likelihood that an under-performing builder will be replaced is small. Also, there is comparatively little incentive for the sole builder to innovate. With multiple builders, replacement of an under performing builder is comparatively easier, builders compete, and such competition opens the way to offering future work as an incentive for excellence in design, construction and service.

2. Best Value Competition

“The competition must be run for “best value” rather than simply for “low cost.” The idea . . . is not simply to get cheaper services; rather it is to get better services at lower costs.”

RCI chooses its partners competitively, but the competitions are entirely based on technical and management expertise. They do not consider cost. Step one of the two-step process evaluated twenty-two potential partners on Administrative Minimum Requirements (essentially pass/fail) and experience (with 8 subparts), financial capabilities, organizational capabilities (corporate level), past performance, and small business utilization. The three potential partners who were judged to be in the competitive range then presented oral proposals with documentation. The second-step proposals were judged on an installation-specific preliminary project concept statement, financial return, organizational capabilities, and small business utilization.

The Request for Qualifications describes the process as “best value.” Is technical excellence the same as best value? Although we hope that technical excellence plays a part in the determination of best value, focusing on technical excellence without considering cost opens the way to excellent and expensive products. It is easy to see how benefit derives from RCI’s process; it is less easy to demonstrate that it is the “greatest overall benefit.”

Regardless of the claim in their RFQs, RCI's Request for Qualifications process and selections are not best value competitions. RCI's emphasis on factors other than price is as misdirected as is an over-riding emphasis on the lowest price. Lowest price can result in cheap, inferior products. Failing to consider price can result in gold-plating. Certainly developing the CDMP jointly puts the Government in a position to limit gold-plating, but without the counter-balancing influence of other contractors.

It also means that the contract itself must be a "performance-based contract," i.e., one that specifies what the buyer broadly is striving to achieve, but doesn't tell the supplier how to do it.

First, the agreement that joins the Army to Clark Pinnacle is not a contract. The Community Development Management Plan development process that comes after selection of a contractor offers the contractor considerable input into the plan. For example, the Army and Clark Pinnacle held public meeting during development of the CDMP. During those meetings Clark Pinnacle proposed floor plans for the new houses. When military spouses proposed changes to those plans, Clark Pinnacle's architects incorporated those recommendations into the plans. If the purpose of a performance specification is to shift design responsibility and risk from the Government to the contractor, then RCI's Alpha-contracting-like process is not quite a performance-based agreement. As a co-developer of the CDMP, the Government still bears some of the responsibility and risk for the plan, but the process does rely considerably on the contractor's expertise and creativity.

Once the CDMP has been prepared, staffed, and approved, no competitive process follows. The process to this point has considered only the cost of working with Clark-Pinnacle to build and maintain housing. While the process selects a well-qualified corporate partner and produces a good development and management plan; there is no evidence that, in executing that plan, the corporate partner will produce the best value for the Government or that a different corporate partner might not have produced more value with a different development plan.

In the case of Monterey Bay Military Housing, LLC, the Corporation awarded a noncompetitive construction contract to Clark Construction and a management contract to Pinnacle Realty Management. Might other construction and property management

contractors have provided better value than Clark and Pinnacle? Might the Government have received better value from multiple construction contractors and multiple management companies? With RCI's process, we cannot know.

3. Government Control

“Even when the Government contracts out work to be performed, it does not give up any of the control or management responsibilities . . . This means that the government still has a strong oversight function: to manage the contract and monitor its performance and cost. If the work is not done properly, the responsibility still rests with the government.”

Again, RCI does not contract for housing. Instead, it joins with a corporate partner to produce housing. Prof. Gansler suggests that such a corporate arrangement does not relieve the Government of its responsibility to assure that the housing is of acceptable quality and is managed and maintained acceptably.

Without access to the CDMP, it is impossible for us to know the extent to which it defines quality and timeliness. We know that it contains a detailed construction and renovation schedule, and we know that it specifies a separate quality assurance contractor. However, what is not clear is the Government's enforcement rights should there be a performance issue.

After acceptance of the CDMP and incorporation, the Government becomes a minority owner. We are concerned about the enforcement provisions in the relationship at this point. The Corporation can have volumes of operating rules and agreements, but that documentation is only as effective as its enforcement provisions. The RCI PMs commented that they could fire an uncooperative or nonperforming builder or property manager. Firing or otherwise controlling a majority partner is another issue altogether.

The Corporation has contracted separately inspectors to assure quality. We are, skeptical, however, about the authority of a quality assurance firm that is under contract to the Corporation. The Corporation has also appointed a board with public and private members to oversee the housing communities. Certainly the public members, e.g. the Superintendent of the Naval Postgraduate School, will be concerned for the quality of construction and maintenance.

The Government quality assurance representative at Fort Meade commented that her role changed considerably when the Army joined with Picerne to build and renovate

housing. As a Government inspector of contractors' supplies and services, she was accustomed to rejecting nonconforming products. But her role changed. Instead of rejecting nonconforming material, she must now bring quality issues to the conference table where the corporation determines what to do about them. She commented that she has been satisfied with the results, so far, but that the process is far more political and time-consuming than when she had direct control (Lawrence, 2003).

Luckily for the Monterey RCI PM, the competitive nature of the commercial marketplace provides incentives for the Corporation to produce and maintain acceptable housing. Otherwise, neither military nor civilian renters will choose to live in it. They have a choice. But at Fort Meade, all the housing is inside the fence, reducing its appeal to private sector renters. And private-sector housing, while plentiful, is a thirty-minute commute away. The forces of the commercial market place should still be powerful enough to encourage building and maintaining attractive communities, but they are different from Monterey's. And what of Fort Irwin and Fort Polk and all other sites where there is not active and healthy competition in housing? Those renters do not have a choice.

4. Metrics

"There is a critical need for detailed metrics." Professor Gansler elaborates on his recommendations for effective management (see #3 above) by insisting on the need for early agreement on measures of cost and performance. Probably we would add schedule" to cost and performance.

Without access to CDMPs it is difficult to determine all the metrics they include. Based on the incentive fee information in Appendix C, we can conclude that the programs include significant, detailed metrics. For example, the property management incentive fees at Fort Meade (the only documentation from any CDMP we were permitted to have) require customer service, maintenance service, financial, occupancy and quality of life metrics. Fort Meade's Commander will award the incentive portion of the contractor's property management fee, based on these metrics.

Based on the Army's RCI fee guidance, also included in Appendix C, we infer that there are similar incentives and metrics for Development Management, Construction

Management, and Other. Without access to the specific metrics, we are unable to access their potential effectiveness.

I. RISKS AND RECOMMENDATIONS

1. Functioning in the Commercial Market Place

Kristine Lawrence, Fort Meade RCI's Assistant PM for Property Management noted a problem that others have mentioned but not emphasized. She pointed out the Government personnel are at a disadvantage when working with Picerne. She described public meetings, chaired jointly by Government and Picerne personnel, at which only the Picerne personnel spoke. Additionally, she described the continuing pressure Picerne puts on the relationship.

For example, their CDMP requires that Picerne maintain a Customer Service office, open for long hours. But Picerne decided unilaterally to shorten those hours. In response to the Government's concern, Picerne commented that the CDMP is a guide but should not be taken literally. As conditions change, the CDMP must change or be interpreted differently to fit the changing conditions. Ms Lawrence commented that the Government's reaction in several such situations is to concur, either tacitly or overtly with the contractor.

She went on to explain that although Government personnel had been trained in writing a CDMP, they were not trained for day-to-day management of the project in cooperation with a contractor whose business is managing such projects. The Government personnel feel unprepared to confront the contractor in his area of expertise. She noted that she had worked in the Fort Meade Housing Office for seventeen years and knew the housing regulation by heart, but that her prior experience and expertise had little or no application when working with Picerne. (Lawrence, 2003)

Ms Lawrence's comments have important implications for RCI specifically and for the Government's move toward commercial practices generally. Government personnel have an array of tools for working with Government contracts. Contracting personnel attend a dozen or more formal training classes. They have years of experience with contracting problems. When they encounter difficult contractual problems, they can consult attorneys who are experts in Government contract law or administrative personnel with years of experience managing contracts and contractors. Where will they

look for expertise in dealing with a contractor in a commercial and corporate environment?

The structure of Government contracting dictates that contractors must comply with rules written by and for the Government if they wish to do business with us. With RCI and many other commercial practices, the rules are changed. Instead of contractors playing by Government rules, Government personnel play by the rules of the commercial market place. For example, when the Army joins a developer in a public-private Corporation, it agrees to be bound by corporate law in the state in which their Corporation is chartered. How many Government housing or contracting personnel or Government attorneys are experts in corporate law and commercial construction practices in California or Maryland?

If we are to continue down this commercial practices path, we need considerably more training and experience in commercial practices. Prof. Gansler cautions that we must retain oversight of the service and supplies we acquire through commercial methods. Without training and experience in commercial practices, we are not prepared to protect the Government's interest.

2. Preparation for Government Tinkering

The history of Military Housing contains several examples of Congressional intervention. Congress complained that mortgage rates for Capehart Housing made the units more expensive than if funded with appropriated funds (which Congress had been unwilling to appropriate). When the Kennedy administration scaled back Capehart, Congress appropriated funding to buy all the Capehart units outright. Congress limited profits in Wherry Housing when a scandal loomed, dealing the program a deathblow. We can only speculate what may happen if a developer complains to his Congressman that the Government is limiting his profits or if the *Washington Post* runs a story about unconscionable profits in an Army RCI venture.

In his "Military Housing Privatization Initiative: Background and Issues" Daniel Else comments that Budget Scoring, especially the \$0 score associated with real property, is subject to reinterpretation by OMB. (Else, 2001) In all of its sites, Army RCI trades its real property for equity in a corporation or partnership. It can do this because its real property has no budgetary impact. If OMB significantly changes these scores, it could

profoundly affect the methods DoD in general and the Army specifically uses to revitalize its military housing.

In its original version, Army RCI permitted housing to be built to local standards. Donald Spigelmyer, Army RCI Program Manager, commented that higher-level intervention forced his program to standardize construction standards. (Spigelmyer, 2003) Adopting the standards probably drives up building costs in areas where building standards are less strict. Worse, the standardization may set a precedent that restricts local RCI offices' ability to adapt the program to meet local conditions.

Kristine Lawrence commented that the Army's Assistant Chief of Staff for Installation Management has already stated that profits from the richer sites—those with high BAH, e.g., Fort Meade, Fort Belvoir, Monterey, and Hawaii, should be used to subsidize the poorer sites, e.g., Fort Polk, developing a nationwide minimum standard for Army housing. (Lawrence, 2003) Such a plan reduces the incentives for individual sites to control costs.

It also leads the Army into the morass of defining a nationwide minimum housing standard. Theoretically, BAH reflects local housing costs. It does not necessarily reflect the cost to rent the same house at each site. It is entirely possible that the housing standard in Monterey is higher than in Fort Polk. It might be difficult to explain to the populace around Fort Polk (and their Congressional delegation) that Army families have nicer homes than does the general public because Monterey, Fort Belvoir, and Fort Meade raise the Army's standard.

Such a plan also has the effect of redistributing BAH after Congress has endorsed the standards for various locations around the country. Congress and taxpayers might justly conclude that if the entire BAH is not required to pay for housing in and around Fort Meade or Monterey, then perhaps the BAH for such sites ought to be lowered.

3. BAH

RCI depends on the value of its land and buildings and on BAH. The President and Congress have agreed to increase BAH until the average service member's out-of-pocket expenses for housing are zero. Thereafter, BAH must keep pace with housing costs. If, because of a budget crunch, change of administration, or any other reason, BAH does not keep pace with housing costs; then the economics of RCI fall apart. For

example, the Corporation relies on BAH for much of its income. If BAH disappears, declines, or does not keep pace with housing costs; the Corporation's balance sheet changes. As the difference between BAH and actual housing costs increases, the financial health of RCI corporations could be affected adversely.

As the difference between BAH and actual costs increases, service members' will have fewer housing choices. Competition among housing sources in Monterey is important to the success of RCI in Monterey. If service members do not have adequate funding, that competition disappears, and they will feel compelled to live in Corporation housing, regardless of its quality. Under such circumstances, there is little incentive for the Corporation to maintain high construction and maintenance standards.

4. Cost Plus Percentage of Cost

The RCI Program Financial/Fee Information, included in Appendix C, describes the Development Management Fee as “. . .between 3% and 5% of the total development costs. The amount included in total development costs will be agreed upon during the development of the CDMP. . .” Similarly, the Construction Management fee is “. . .3% to 6% of the total hard cost of construction. A material portion of this fee should be performance based. The amount included in total hard cost will be agreed upon during the development of the CDMP for the project.” If this were a Government contract, it would come dangerously close to an illegal cost plus percentage of cost contract.

The important issue is not whether the contract is illegal but whether it is advisable. Cost plus percentage of cost contracts encourage a contractor to run up costs in order to increase his fee. RCI's fees are not based on actual costs; they are based on projected costs. So, instead of encouraging a contractor to incur actual costs, RCI encourages a contractor to inflate his cost estimates during the preparation of the CDMP. The incentives in the fees also encourage the contractor to inflate his estimates. When the contractor incurs less than his estimates, he earns incentives for cost under runs. Without competition, there are no other contractors' estimates with which the winning contractor's estimates can be compared. It is not clear that the Government had or used cost analysts to consider the contractor's estimates, as it would with a sole source contract nor is there any evidence that the Government prepared an independent cost estimate.

5. Fifty Years

Rental housing takes a long time to earn a return on investment because of the considerable costs of land and of construction. Costs will vary by site. So, the break-even point will vary by site and by the ancillary facilities and the level of maintenance. Given the agree-upon costs in a CDMP, it should be possible to calculate the point at which construction costs are recouped. It is difficult to justify continuing a noncompetitive relationship with a builder beyond that point, but RCI uses a standard fifty-year agreement with a twenty-five year option. Property management is a different issue. Given that the threat of competition encourages innovation and cost control, a variety of incentive arrangements, options, award terms are available.

With shorter-term arrangements, the Government can choose to renew a contractor with which it has built an excellent working relationship or not renew a troublesome contractor. With a fifty-year arrangement, the Government does not have the option of not renewing. Because this is not a contractual relationship, normal Government contracting termination procedures do not apply.

J. BEST PRACTICES

Regardless of whether the final instrument is a Government contract, other transaction, or a public-private corporation; the marketplace has developed some basic principles. Acquisition personnel understand these principles, but RCI does not rely on the Army's acquisition community. Worse, even it chooses not to use the Army acquisition community to execute its agreements, there appears to be no excuse for not tapping acquisition's vast experience. Although RCI uses some of acquisition's forms and procedures, e.g., formal source selection and alpha contracting, it ignores some of acquisition's basic principles

1. Competition

Competition works. It lowers prices. It increases innovation. It keeps everyone sharp. Price competition alone can result in shoddy products or services. In contrast, technical competition alone can result in gold-plated products and services. Balancing technical excellence against cost produces the best deal. RCI conducted a technical competition for military housing in Monterey, but it did not consider price as a factor.

We can be confident that RCI selected a technically competent corporate partner. But RCI cannot credibly claim that it got the best price or the best value.

The FAR requires a contracting officer to certify that a contract price is fair and reasonable—a price that a prudent man would pay in a competitive environment. In our private dealings, we all want to be sure that we pay a fair and reasonable price. RCI's corporations are not Government contracts, but taxpayers still have a right to expect that the Army will manage its funds and other resources prudently. Even if we are confident that RCI will produce attractive livable neighborhoods, we cannot be sure that it produced them for a fair and reasonable price.

2. Subject Matter Expertise

The Army Corps of Engineers has considerable expertise in planning and managing large construction projects. Donald Spigelmyer, the Army's PM for RCI, worked for the Corps of Engineers before joining the Task Force which developed RCI. We find occasional references to the Corps of Engineers in literature about Army family housing. There is even a Corps of Engineers website dealing with RCI, but it has not been updated for years. Although the Army RCI PM writes all first-step Requests for Qualifications, the Baltimore District of the Corps of Engineers issues them.

Strikingly, that appears to be the extent of the Corps' current involvement in RCI. We have seen organizational rivalries doom programs, but the stakes in RCI are huge. If RCI accomplishes the Army's goal of revitalizing all its deteriorating housing, it will be a \$7 billion dollar program. Ignoring the Corps of Engineers expertise in construction oversight and management increases program risk unacceptably.

K. CONCLUSION

RCI will work at the sites where there is considerable competition from private-sector housing. At those sites the commercial marketplace will force the RCI corporations to produce and maintain acceptable family housing. Otherwise, Army families, armed with adequate BAH, will choose to live elsewhere. In Monterey, given its very high BAH, RCI may produce showplace military communities, like the artist's renderings included herein.

RCI's success at more isolated sites is less certain. RCI corporations may have incentives to produce the required number of family housing units; but the quality of the housing, maintenance, and associated amenities is likely to be lower. Government participation in the corporations will tend to keep quality at an acceptable level, mitigating the worst abuses of the monopolies. But without competition, it seems certain that housing will not be as nice as at the competitive sites.

Figure 5 – 6: Artist's Rendering of High Mission, FGO's Quarters

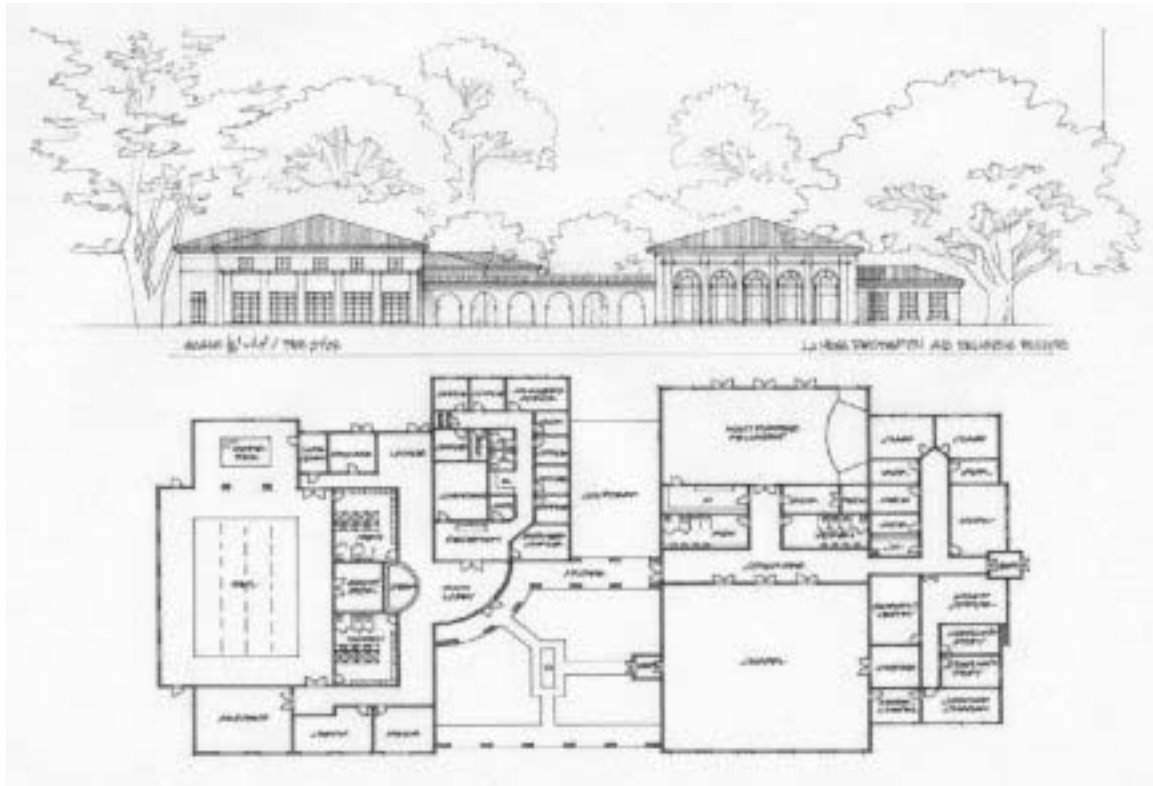


Source: from the Monterey RCI website

APPENDIX A. DEFINITIONS AND ABBREVIATIONS

BAQ	Basic Allowance for Quarters.
BAH	Basic Allowance for Housing.
CDMP	Community Development Management Plan
MFH	Military Family Housing. Housing units provided specifically for military family occupancy, including units obtained under section 801/802 and units owned and operated by DoD and funded through MILCON appropriations.
MHPI	Military Housing Privatization Initiative
MILCON	Military Construction. Appropriations funding for major projects such as bases, schools, maintenance and storage facilities, and military family housing.
OMC	Ord Military Community
PAM	Portfolio and Asset Management
PPV	Public Private Venture. The Navy's program for privatizing housing under MHPI.
Privatized Housing	Housing units made available to rent to military families under the Military Housing Privatization Act.
RCI	Residential Communities Initiative. The Army's program for privatizing housing under MHPI.
RFQ	Request for Qualifications. The "solicitation" the Army issues to invite interested parties to submit qualifications for partnering with the Army in housing revitalization.

Figure A - 1: Architect's Elevation of the La Mesa Recreation Center



Source: From Monterey RCI website

APPENDIX B – 1996 DEFENSE AUTHORIZATION ACT

1996 Defense Authorization Act

Public Law 104-106 110 Stat 186

Signed by President Clinton on Saturday, February 10, 1996.

One Hundred Fourth Congress

of the

United States of America

At the Second Session

Begun and held at the City of Washington on Wednesday, the third day of January, one thousand nine hundred and ninety-six

S1124

Thurmond S. (R-SC), 01/26/96, (32488 lines)

Enrolled (finally passed both houses)

AN ACT

To authorize appropriations for fiscal year 1996 for military activities of the Department of Defense, for military construction, and for defense activities of the Department of Energy, to prescribe personnel strengths for such fiscal year for the Armed Forces, to reform acquisition laws and information technology management of the Federal Government, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE XXVIII--GENERAL PROVISIONS

SUBTITLE A--MILITARY HOUSING PRIVATIZATION INITIATIVE

Sec.

2871. Definitions.

2872. General authority.

2873. Direct loans and loan guarantees.

2874. Leasing of housing to be constructed.

2875. Investments in non-governmental entities.

2876. Rental guarantees.

2877. Differential leases payments.

2878. Conveyance or lease of existing property and facilities.

2879. Interim leases.

2880. Unit size and type.

2881. Ancillary supporting facilities.

2882. Assignment of members of the armed forces to housing units.

2883. Department of Defense Housing Funds.

2884. Reports.

2885. Expiration of authority.

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY
HOUSING

**SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION
AND IMPROVEMENT OF MILITARY HOUSING**

Sec.

2871. Definitions.

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2881. Ancillary supporting facilities.

2882. Assignment of members of the armed forces to housing units.

2883. Department of Defense Housing Funds.

2884. Reports.

2885. Expiration of authority.

AMENDMENTS

1999 - Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(h)(2), Oct. 5, 1999, 113 Stat. 849, added item 2875 and struck out former item 2875 "Investments in nongovernmental entities".

SUBCHAPTER REFERRED TO IN OTHER SECTIONS

This subchapter is referred to in section 2814 of this title.

10 USC Sec. 2871 01/23/00
TITLE 10 - ARMED FORCES
Subtitle A - General Military Law
PART IV - SERVICE, SUPPLY, AND PROCUREMENT
CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY
HOUSING
SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND
IMPROVEMENT OF MILITARY HOUSING

Sec. 2871. Definitions

In this subchapter:

(1) The term "ancillary supporting facilities" means facilities related to military housing units, including facilities to provide or support elementary or secondary education, child care centers, day care centers, tot lots, community centers, housing offices, dining facilities, unit offices, and other similar facilities for the support of military housing.

(2) The term "base closure law" means the following:

(A) Section 2687 of this title.

(B) Title II of the Defense Authorization Amendments and Base Closure and Realignment Act (Public Law 100-526; 10 U.S.C. 2687 note).

(C) The Defense Base Closure and Realignment Act of 1990 (part A of title XXIX of Public Law 101-510; 10 U.S.C. 2687 note).

(3) The term "construction" means the construction of military housing units and ancillary supporting facilities or the improvement or rehabilitation of existing units or ancillary supporting facilities.

(4) The term "contract" includes any contract, lease, or other agreement entered into under the authority of this subchapter.

(5) The term "eligible entity" means any private person, corporation, firm, partnership, company, State or local government, or housing authority of a State or local government.

(6) The term "Fund" means the Department of Defense Family Housing Improvement Fund or the Department of Defense Military Unaccompanied Housing Improvement Fund established under section 2883(a) of this title.

(7) The term "military unaccompanied housing" means military housing intended to be occupied by members of the armed forces serving a tour of duty unaccompanied by dependents.

(8) The term "United States" includes the Commonwealth of Puerto Rico.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 544; amended Pub. L. 105-261, div. B, title XXVIII, Sec. 2803, Oct. 17, 1998, 112 Stat. 2202; Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(a), Oct. 5, 1999, 113 Stat. 848.)

AMENDMENTS

1999 - Pars. (5) to (8). Pub. L. 106-65 added par. (5) and redesignated former pars. (5) to (7) as (6) to (8), respectively. 1998 - Par. (1). Pub. L. 105-261 inserted "facilities to provide or support elementary or secondary education," after "including".

10 USC Sec. 2872 01/23/00

TITLE 10 - ARMED FORCES

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SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2872. General authority

In addition to any other authority provided under this chapter for the acquisition or construction of military family housing or military unaccompanied housing, the Secretary concerned may exercise any authority or any combination of authorities provided under this subchapter in order to provide for the acquisition or construction by eligible entities of the following:

(1) Family housing units on or near military installations within the United States and its territories and possessions.

(2) Military unaccompanied housing units on or near such military installations.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 545; Amended Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(b), Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS

1999 - Pub. L. 106-65 substituted "eligible entities" for "private persons" in introductory provisions.

10 USC Sec. 2873 01/23/00

TITLE 10 - ARMED FORCES

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PART IV - SERVICE, SUPPLY, AND PROCUREMENT

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SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2873. Direct loans and loan guarantees

(a) Direct Loans. - (1) Subject to subsection (c), the Secretary concerned may make direct loans to an eligible entity in order to provide funds to the eligible entity for the acquisition or construction of housing units that the Secretary determines are suitable for use as military family housing or as military unaccompanied housing.

(2) The Secretary concerned shall establish such terms and conditions with respect to loans made under this subsection as the Secretary considers appropriate to protect the interests of the United States, including the period and frequency for repayment of such loans and the obligations of the obligors on such loans upon default.

(b) Loan Guarantees. - (1) Subject to subsection (c), the Secretary concerned may guarantee a loan made to an eligible entity if the proceeds of the loan are to be used by the eligible entity to acquire, or construct housing units that the Secretary determines are suitable for use as military family housing or as military unaccompanied housing.

(2) The amount of a guarantee on a loan that may be provided under paragraph (1) may not exceed the amount equal to the lesser of -

(A) the amount equal to 80 percent of the value of the project;

or

(B) the amount of the outstanding principal of the loan.

(3) The Secretary concerned shall establish such terms and conditions with respect to guarantees of loans under this subsection as the Secretary considers appropriate to protect the interests of the United States, including the rights and obligations of obligors of such loans and the rights and obligations of the United States with respect to such guarantees.

(c) Limitation on Direct Loan and Guarantee Authority. - Direct loans and loan guarantees may be made under this section only to the extent that appropriations of budget authority to cover their cost (as defined in section 502(5) of the Federal Credit Reform Act of 1990 (2 U.S.C. 661a(5))) are made in advance, or authority is otherwise provided in appropriation Acts. If such appropriation or other authority is provided, there may be established a financing account (as defined in section 502(7) of such Act (2 U.S.C. 661a(7))), which shall be available for the disbursement of direct loans or payment of claims for payment on loan guarantees under this section and for all other cash flows to and from the Government as a result of direct loans and guarantees made under this section.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 545; amended Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(c), Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS: 1999 - Subsec. (a)(1). Pub. L. 106-65, Sec. 2803(c)(1), substituted "an eligible entity" for "persons in the private sector" and "the eligible entity" for "such persons". Subsec. (b)(1). Pub. L. 106-65, Sec. 2803(c)(2), substituted "an eligible entity" for "any person in the private sector" and "the eligible entity" for "the person".

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in section 2883 of this title.

10 USC Sec. 2874 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2874. Leasing of housing to be constructed

(a) Build and Lease Authorized. - The Secretary concerned may enter into contracts for the lease of military family housing units or military unaccompanied housing units to be constructed under this subchapter.

(b) Lease Terms. - A contract under this section may be for any period that the Secretary concerned determines appropriate and may provide for the owner of the leased property to operate and maintain the property.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 546.)

10 USC Sec. 2875 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2875. Investments

(a) Investments Authorized. - The Secretary concerned may make investments in an eligible entity carrying out projects for the acquisition or construction of housing units suitable for use as military family housing or as military unaccompanied housing.

(b) Forms of Investment. - An investment under this section may take the form of an acquisition of a limited partnership interest by the United States, a purchase of stock or other equity instruments by the United States, a purchase of bonds or other debt instruments by the United States, or any combination of such forms of investment.

(c) Limitation on Value of Investment. - (1) The cash amount of an investment under this section in an eligible entity may not exceed an amount equal to 33 1/3 percent of the capital cost (as determined by the Secretary concerned) of the project or projects that the eligible entity proposes to carry out under this section with the investment.

(2) If the Secretary concerned conveys land or facilities to an eligible entity as all or part of an investment in the eligible entity under this section, the total value of the investment by the Secretary under this section may not exceed an amount equal to 45 percent of the capital cost (as determined by the Secretary) of the project or projects that the eligible entity proposes to carry out under this section with the investment.

(3) In this subsection, the term "capital cost", with respect to a project for the acquisition or construction of housing, means the total amount of the costs included in the basis of the housing for Federal income tax purposes.

(d) Collateral Incentive Agreements. - The Secretary concerned shall enter into collateral incentive agreements with eligible entities in which the Secretary makes an investment under this section to ensure that a suitable preference will be afforded members of the armed forces and their dependents in the lease or purchase, as the case may be, of a reasonable number of the housing units covered by the investment.

(e) Congressional Notification Required. - Amounts in the Department of Defense Family Housing Improvement Fund or the Department of Defense Military Unaccompanied Housing Improvement Fund may be used to make a cash investment under this section in an eligible entity only after the end of the 30-day period beginning on the date the Secretary of Defense submits written notice of, and justification for, the investment to the appropriate committees of Congress.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 546; amended Pub. L. 105-85, div. B, title XXVIII, Sec. 2805, Nov. 18, 1997, 111 Stat. 1991; Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(d), (h)(1), Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS

1999 - Pub. L. 106-65, Sec. 2803(h)(1), struck out "in nongovernmental entities" after "Investments" in section catchline. Subsec. (a). Pub. L. 106-65, Sec. 2803(d)(1), substituted "an eligible entity" for "nongovernmental entities". Subsec. (c). Pub. L. 106-65, Sec. 2803(d)(2), substituted "an eligible entity" for "a nongovernmental entity" in pars. (1) and (2) and "the eligible entity" for "the entity" wherever appearing in pars. (1) and (2). Subsec. (d). Pub. L. 106-65, Sec. 2803(d)(3), substituted "eligible" for "nongovernmental". Subsec. (e). Pub. L. 106-65, Sec. 2803(d)(4), substituted "an eligible entity" for "a nongovernmental entity". 1997 - Subsec. (e). Pub. L. 105-85 added subsec. (e).

SECTION REFERRED TO IN OTHER SECTIONS: This section is referred to in section 2883 of this title.

10 USC Sec. 2876 01/23/00
TITLE 10 - ARMED FORCES
Subtitle A - General Military Law
PART IV - SERVICE, SUPPLY, AND PROCUREMENT
CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING
SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2876. Rental guarantees

The Secretary concerned may enter into agreements with eligible entities that acquire or construct military family housing units or military unaccompanied housing units under this subchapter in order to assure -

- (1) the occupancy of such units at levels specified in the agreements; or
- (2) rental income derived from rental of such units at levels specified in the agreements.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 546; amended Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(e), Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS

1999 - Pub. L. 106-65 substituted "eligible entities" for "private persons" in introductory provisions.

10 USC Sec. 2877 01/23/00
TITLE 10 - ARMED FORCES
Subtitle A - General Military Law
PART IV - SERVICE, SUPPLY, AND PROCUREMENT
CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING
SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2877. Differential lease payments

Pursuant to an agreement entered into by the Secretary concerned and a lessor of military family housing or military unaccompanied housing to members of the armed forces, the Secretary may pay the lessor an amount in addition to the rental payments for the housing made by the members as the Secretary determines appropriate to encourage the lessor to make the housing available to members of the armed forces as military family housing or as military unaccompanied housing.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 547; amended PL 106-65, div. B, title XXVIII, Sec. 2803(f), Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS: 1999 - Pub. L. 106-65 substituted "a lessor" for "a private lessor".

10 USC Sec. 2878 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2878. Conveyance or lease of existing property and facilities

(a) Conveyance or Lease Authorized. - The Secretary concerned may convey or lease property or facilities (including ancillary supporting facilities) to eligible entities for purposes of using the proceeds of such conveyance or lease to carry out activities under this subchapter.

(b) Inapplicability to Property at Installation Approved for Closure. - The authority of this section does not apply to property or facilities located on or near a military installation approved for closure under a base closure law.

(c) Terms and Conditions. - (1) The conveyance or lease of property or facilities under this section shall be for such consideration and upon such terms and conditions as the Secretary concerned considers appropriate for the purposes of this subchapter and to protect the interests of the United States.

(2) As part or all of the consideration for a conveyance or lease under this section, the purchaser or lessor (as the case may be) shall enter into an agreement with the Secretary to ensure that a suitable preference will be afforded members of the armed forces and their dependents in the lease or sublease of a reasonable number of the housing units covered by the conveyance or lease, as the case may be, or in the lease of other suitable housing units made available by the purchaser or lessee.

(d) Inapplicability of Certain Property Management Laws. - The conveyance or lease of property or facilities under this section shall not be subject to the following provisions of law:

(1) Section 2667 of this title.

(2) The Federal Property and Administrative Services Act of 1949 (40 U.S.C. 471 et seq.).

(3) Section 321 of the Act of June 30, 1932 (commonly known as the Economy Act) (40 U.S.C. 303b).

(4) Section 501 of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11411).

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 547; amended Pub. L. 105-85, div. A, title X, Sec. 1073(a)(60), Nov. 18, 1997, 111 Stat. 1903; Pub. L. 106-65, div. B, title XXVIII, Sec. 2803(g), Oct. 5, 1999, 113 Stat. 849.)

REFERENCES IN TEXT

The Federal Property and Administrative Services Act of 1949, referred to in subsec. (d)(2), is act June 30, 1949, ch. 288, 63 Stat. 377, as amended. Provisions of the

Act relating to management and disposal of Government property are classified to chapter 10 (Sec. 471 et seq.) of Title 40, Public Buildings, Property, and Works. For complete classification of this Act to the Code, see Short Title note set out under section 471 of Title 40 and Tables.

AMENDMENTS: 1999 - Subsec. (a). Pub. L. 106-65 substituted "eligible entities" for "private persons". 1997 - Subsec. (d)(4). Pub. L. 105-85 substituted "11411" for "11401".

SECTION REFERRED TO IN OTHER SECTIONS: This section is referred to in sections 2883, 2884 of this title.

10 USC Sec. 2879 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2879. Interim leases

Pending completion of a project to acquire or construct military family housing units or military unaccompanied housing units under this subchapter, the Secretary concerned may provide for the interim lease of such units of the project as are complete. The term of a lease under this section may not extend beyond the date of the completion of the project concerned.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 547.)

10 USC Sec. 2880 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2880. Unit size and type

(a) Conformity With Similar Housing Units in Locale. – The Secretary concerned shall ensure that the room patterns and floor areas of military family housing units and military unaccompanied housing units acquired or constructed under this subchapter are generally comparable to the room patterns and floor areas of similar housing units in the locality concerned.

(b) Inapplicability of Limitations on Space by Pay Grade. –

(1) Section 2826 of this title shall not apply to military family housing units acquired or constructed under this subchapter.

(2) The regulations prescribed under section 2856 of this title shall not apply to any military unaccompanied housing unit acquired or constructed under this subchapter unless the unit is located on a military installation.

(Added PL 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 548.)

10 USC Sec. 2881 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2881. Ancillary supporting facilities

(a) Authority To Acquire or Construct. - Any project for the acquisition or construction of military family housing units or military unaccompanied housing units under this subchapter may include the acquisition or construction of ancillary supporting facilities for the housing units concerned.

(b) Restriction. - A project referred to in subsection (a) may not include the acquisition or construction of an ancillary supporting facility if, as determined by the Secretary concerned, the facility is to be used for providing merchandise or services in direct competition with -

(1) the Army and Air Force Exchange Service;

(2) the Navy Exchange Service Command;

(3) a Marine Corps exchange;

(4) the Defense Commissary Agency; or

(5) any nonappropriated fund activity of the Department of Defense for the morale, welfare, and recreation of members of the armed forces.

(Added PL 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 548; amended PL 106-65, div. B, title XXVIII, Sec. 2804, Oct. 5, 1999, 113 Stat. 849.)

AMENDMENTS: 1999 - PL 106-65 designated existing provisions as subsec. (a), inserted heading, and added subsec. (b).

10 USC Sec. 2882 01/23/00
TITLE 10 - ARMED FORCES
Subtitle A - General Military Law
PART IV - SERVICE, SUPPLY, AND PROCUREMENT
CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY
HOUSING
SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND
IMPROVEMENT OF MILITARY HOUSING

Sec. 2882. Assignment of members of the armed forces to housing units

(a) In General. - The Secretary concerned may assign members of the armed forces to housing units acquired or constructed under this subchapter.

(b) Effect of Certain Assignments on Entitlement to Housing Allowances. - (1) Except as provided in paragraph (2), housing referred to in subsection (a) shall be considered as quarters of the United States or a housing facility under the jurisdiction of a uniformed service for purposes of section 403 of title 37.

(2) A member of the armed forces who is assigned in accordance with subsection (a) to a housing unit not owned or leased by the United States shall be entitled to a basic allowance for housing under section 403 of title 37.

(c) Lease Payments Through Pay Allotments. - The Secretary concerned may require members of the armed forces who lease housing in housing units acquired or constructed under this subchapter to make lease payments for such housing pursuant to allotments of the pay of such members under section 701 of title 37.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 548; amended Pub. L. 105-85, div. A, title VI, Sec. 603(d)(2)(C), Nov. 18, 1997, 111 Stat. 1783.)

AMENDMENTS: 1997 - Subsec. (b)(1). PL 105-85, Sec. 603(d)(2)(C)(i), substituted "section 403" for "section 403(b)". Subsec. (b)(2). PL 105-85, Sec. 603(d)(2)(C)(ii), substituted "basic allowance for housing under section 403 of title 37" for "basic allowance for quarters under section 403 of title 37 and, if in a high housing cost area, a variable housing allowance under section 403a of that title".

EFFECTIVE DATE OF 1997 AMENDMENT: Amendment by PL 105-85 effective Jan. 1, 1998, see section 603(e) of PL 105-85, set out as a note under section 5561 of Title 5, Government Organization and Employees.

10 USC Sec. 2883 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2883. Department of Defense Housing Funds

(a) Establishment. - There are hereby established on the books of the Treasury the following accounts:

(1) The Department of Defense Family Housing Improvement Fund.

(2) The Department of Defense Military Unaccompanied Housing Improvement Fund.

(b) Commingling of Funds Prohibited. - (1) The Secretary of Defense shall administer each Fund separately.

(2) Amounts in the Department of Defense Family Housing Improvement Fund may be used only to carry out activities under this subchapter with respect to military family housing.

(3) Amounts in the Department of Defense Military Unaccompanied Housing Improvement Fund may be used only to carry out activities under this subchapter with respect to military unaccompanied housing.

(c) Credits to Funds. - (1) There shall be credited to the Department of Defense Family Housing Improvement Fund the following:

(A) Amounts authorized for and appropriated to that Fund.

(B) Subject to subsection (f), any amounts that the Secretary of Defense transfers, in such amounts as provided in appropriation Acts, to that Fund from amounts authorized and appropriated to the Department of Defense for the acquisition or construction of military family housing.

(C) Proceeds from the conveyance or lease of property or facilities under section 2878 of this title for the purpose of carrying out activities under this subchapter with respect to military family housing.

(D) Income derived from any activities under this subchapter with respect to military family housing, including interest on loans made under section 2873 of this title, income and gains realized from investments under section 2875 of this title, and any return of capital invested as part of such investments.

(E) Any amounts that the Secretary of the Navy transfers to that Fund pursuant to section 2814(i)(3) of this title, subject to the restrictions on the use of the transferred amounts specified in that section.

(2) There shall be credited to the Department of Defense Military Unaccompanied Housing Improvement Fund the following:

(A) Amounts authorized for and appropriated to that Fund.

(B) Subject to subsection (f), any amounts that the Secretary of Defense transfers, in such amounts as provided in appropriation Acts, to that Fund from amounts authorized

and appropriated to the Department of Defense for the acquisition or construction of military unaccompanied housing.

(C) Proceeds from the conveyance or lease of property or facilities under section 2878 of this title for the purpose of carrying out activities under this subchapter with respect to military unaccompanied housing.

(D) Income derived from any activities under this subchapter with respect to military unaccompanied housing, including interest on loans made under section 2873 of this title, income and gains realized from investments under section 2875 of this title, and any return of capital invested as part of such investments.

(E) Any amounts that the Secretary of the Navy transfers to that Fund pursuant to section 2814(i)(3) of this title, subject to the restrictions on the use of the transferred amounts specified in that section.

(d) Use of Amounts in Funds. –

(1) In such amounts as provided in appropriation Acts and except as provided in subsection (e), the Secretary of Defense may use amounts in the Department of Defense Family Housing Improvement Fund to carry out activities under this subchapter with respect to military family housing, including activities required in connection with the planning, execution, and administration of contracts entered into under the authority of this subchapter. The Secretary may also use for expenses of activities required in connection with the planning, execution, and administration of such contracts funds that are otherwise available to the Department of Defense for such types of expenses.

(2) In such amounts as provided in appropriation Acts and except as provided in subsection (e), the Secretary of Defense may use amounts in the Department of Defense Military Unaccompanied Housing Improvement Fund to carry out activities under this subchapter with respect to military unaccompanied housing, including activities required in connection with the planning, execution, and administration of contracts entered into under the authority of this subchapter. The Secretary may also use for expenses of activities required in connection with the planning, execution, and administration of such contracts funds that are otherwise available to the Department of Defense for such types of expenses.

(3) Amounts made available under this subsection shall remain available until expended. The Secretary of Defense may transfer amounts made available under this subsection to the Secretaries of the military departments to permit such Secretaries to carry out the activities for which such amounts may be used.

(e) Limitation on Obligations. - The Secretary may not incur an obligation under a contract or other agreement entered into under this subchapter in excess of the unobligated balance, at the time the contract is entered into, of the Fund required to be used to satisfy the obligation.

(f) Notification Required for Transfers. - A transfer of appropriated amounts to a Fund under paragraph (1)(B) or (2)(B) of subsection (c) may be made only after the end of the 30-day period beginning on the date the Secretary of Defense submits written notice of, and justification for, the transfer to the appropriate committees of Congress.

(g) Limitation on Amount of Budget Authority. - The total value in budget authority of all contracts and investments undertaken using the authorities provided in this subchapter shall not exceed-

- (1) \$850,000,000 for the acquisition or construction of military family housing; and
- (2) \$150,000,000 for the acquisition or construction of military unaccompanied housing.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 548; amended Pub. L. 104-201, div. B, title XXVIII, Sec. 2804, Sept. 23, 1996, 110 Stat. 2788; Pub. L. 106-65, div. B, title XXVIII, Sec. 2802(b), Oct. 5, 1999, 113 Stat. 848.)

AMENDMENTS: 1999 - Subsec. (c)(1)(E). PL 106-65, Sec. 2802(b)(1), added subpar. (E). Subsec. (c)(2)(E). PL 106-65, Sec. 2802(b)(2), added subpar. (E). 1996 - Subsec. (d)(1), (2). PL 104-201 inserted at end "The Secretary may also use for expenses of activities required in connection with the planning, execution, and administration of such contracts funds that are otherwise available to the Department of Defense for such types of expenses."

SECTION REFERRED TO IN OTHER SECTIONS: This section is referred to in sections 2814, 2854a, 2871, 2884 of this title.

10 USC Sec. 2884 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2884. Reports

(a) Project Reports. - (1) The Secretary of Defense shall transmit to the appropriate committees of Congress a report describing -

(A) each contract for the acquisition or construction of family housing units or unaccompanied housing units that the Secretary proposes to solicit under this subchapter; and

(B) each conveyance or lease proposed under section 2878 of this title.

(2) The report shall describe the proposed contract, conveyance, or lease and the intended method of participation of the United States in the contract, conveyance, or lease and provide a justification of such method of participation. The report shall be submitted not later than 30 days before the date on which the Secretary issues the contract solicitation or offers the conveyance or lease.

(b) Annual Reports. - The Secretary of Defense shall include each year in the materials that the Secretary submits to Congress in support of the budget submitted by the President pursuant to section 1105 of title 31 the following:

(1) A report on the expenditures and receipts during the preceding fiscal year covering the Funds established under section 2883 of this title.

(2) A methodology for evaluating the extent and effectiveness of the use of the authorities under this subchapter during such preceding fiscal year.

(3) A description of the objectives of the Department of Defense for providing military family housing and military unaccompanied housing for members of the armed forces.

(Added Pub. L. 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 550.)

FINAL REPORT: Section 2801(b) of Pub. L. 104-106 provided that: "Not later than March 1, 2000, the Secretary of Defense shall submit to the congressional defense committees (Committees on Armed Services and on Appropriations of the Senate and House of Representatives) a report on the use by the Secretary of Defense and the Secretaries of the military departments of the authorities provided by subchapter IV of chapter 169 of title 10, United States Code, as added by subsection (a). The report shall assess the effectiveness of such authority in providing for the construction and improvement of military family housing and military unaccompanied housing."

10 USC Sec. 2885 01/23/00

TITLE 10 - ARMED FORCES

Subtitle A - General Military Law

PART IV - SERVICE, SUPPLY, AND PROCUREMENT

CHAPTER 169 - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

SUBCHAPTER IV - ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING

Sec. 2885. Expiration of authority

The authority to enter into a contract under this subchapter shall expire on February 10, 2001.

(Added PL 104-106, div. B, title XXVIII, Sec. 2801(a)(1), Feb. 10, 1996, 110 Stat. 551; amended PL 105-85, div. A, title X, Sec. 1073(a)(61), Nov. 18, 1997, 111 Stat. 1903.)

AMENDMENTS: 1997 - PL 105-85 substituted "on February 10, 2001" for "five years after the date of the enactment of the National Defense Authorization Act for Fiscal Year 1996".

THE FOLLOWING PROVISIONS AMENDED THE HOUSING
PRIVATIZATION LEGISLATION WHEN THEY WERE ENACTED AS PART OF
H.R. 5408, THE FLOYD D. SPENCE NATIONAL DEFENSE AUTHORIZATION
ACT FOR FISCAL YEAR 2001

SEC. 2805. PROVISION OF UTILITIES AND SERVICES UNDER ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING.

(a) AUTHORITY TO FURNISH ON REIMBURSABLE BASIS- Subchapter IV of chapter 169 of title 10, United States Code, is amended by inserting after section 2872 the following new section:

Sec. 2872a. Utilities and services

(a) AUTHORITY TO FURNISH- The Secretary concerned may furnish utilities and services referred to in subsection (b) in connection with any military housing acquired or constructed pursuant to the exercise of any authority or combination of authorities under this subchapter if the military housing is located on a military installation.

(b) COVERED UTILITIES AND SERVICES- The utilities and services that may be furnished under subsection (a) are the following:

- (1) Electric power.
- (2) Steam.
- (3) Compressed air.
- (4) Water.
- (5) Sewage and garbage disposal.
- (6) Natural gas.
- (7) Pest control.
- (8) Snow and ice removal.
- (9) Mechanical refrigeration.
- (10) Telecommunications service.

(c) REIMBURSEMENT- (1) The Secretary concerned shall be reimbursed for any utilities or services furnished under subsection (a).

(2) The amount of any cash payment received under paragraph (1) shall be credited to the appropriation or working capital account from which the cost of furnishing the utilities or services concerned was paid. Amounts so credited to an appropriation or account shall be merged with funds in such appropriation or account, and shall be available to the same extent, and subject to the same terms and conditions, as such funds.'

(b) CLERICAL AMENDMENT- The table of sections at the beginning of such subchapter is amended by inserting after the item relating to section 2872 the following new item:

2872a. Utilities and services.'

SEC. 2806. EXTENSION OF ALTERNATIVE AUTHORITY FOR ACQUISITION AND IMPROVEMENT OF MILITARY HOUSING.

Section 2885 of title 10, United States Code, is amended by striking 'February 10, 2001' and inserting 'December 31, 2004'.

Figure B – 1: Artist's Rendering of the Ord Military Community Town Hall



Source: from the Monterey RCI website

APPENDIX C. RCI INCENTIVE FEES

RCI PROGRAM FINANCIAL / FEE INFORMATION

December 2002

The Army understands that rates of return differ based on a number of variables. For purposes of evaluating Statements of Qualifications provided in response to Residential Communities Initiative (RCI) solicitations, an industry standard range of fees is provided below. These fees will not be considered in isolation and will in no way be a determinant of actual fees or fee structures negotiated during the Community Development Management Plan (CDMP). Developers are encouraged to exercise creativity in crafting both their fee structure and organization structure in order to maximize funds available for improving the quality of life for soldiers and their families.

1. Property/Asset Management - The Army expects that there will be a fee or series of fees associated with the property management and asset management as in the private sector. However the developer describes the fees associated with the management of the operations of the project and the operations of the entity for the project, the Army expects that, when combined, the fee(s) will be in a range of 3 to 5 of gross rent for available units less vacant units. Moreover, a material portion of this/these fee(s) should be performance based. In addition, given DOD's zero out of pocket BAH initiative, the Army expects there to be a mechanism built into this fee structure that will guard against "windfall profits" going to the developer as related to this initiative.
2. Development Management - The Army expects a development management fee structure that will range between 3 and 5 of the total development costs. The amount included in total development costs will be agreed upon during the development of the CDMP for the project as will the reimbursement, if any, associated with the development staff for the project. The entire development fee should be at risk to the developer in the event that the scope milestones, agreed upon prior to closing, are not achieved due to events within the developer's control.
3. Construction Management - The Army expects that the fee paid to the general contractor will be within a range of 3 to 6 of the total hard cost of construction. A material portion of this fee should be performance based. The amount included in total hard cost will be agreed upon during the development of the CDMP for the project. The Army expects that the annual reimbursement of direct costs associated with the construction (i.e., general conditions and/or overhead) will be evaluated and approved as a budget item each year of the construction.

**RCI Program Financial / Fee Information
December 2002**

4. **Other Fees** - The fees listed above are intended to cover the full array of services provided by the selected developer and accordingly the Army does not expect to pay any other fees to the selected developer out of project funds. In the event that the selected developer has another fee proposed, it will be included and evaluated within one of the three categories listed above.
5. **Return on Invested Equity** - Any cash split proposed by the developer should be treated as the mechanism for the developer to receive a return on his at-risk equity. If there is no contributed equity, the developer should not expect to receive a share of excess cash flow. The developer will be expected to propose a return on his invested equity that is consistent with the risk and duration associated with his investment in this project. The Army does not believe that the risk of capital invested in these projects is commensurate with the equity risk associated with residential development in the private sector. The Army expects the offerer to include a cap on the annual return on investment the developer expects to receive. Caps based on statistics such as "internal rate of return" are not appropriate given the long-term nature of the ground leases.
6. **Summary** - The information provided above is intended to assist the offerer in responding to a Request For Qualifications (RFQ). The Fees and Return on Invested Equity will be reviewed and evaluated both individually and in their entirety for comparison purposes during the selection process and ranked according to the overall financial impact that the proposal has on the project. The selected developer from the RFQ process should expect that, as with all other aspects of their RFQ plan for the project, that the specific details, including the final amount of each fee, will be concluded during the CDMP phase. For additional Program Information, contact the RCI office at 703-692-9898.

**PROPERTY MANAGEMENT
INCENTIVE FEE STRUCTURE
FORT GEORGE G. MEADE**

Revision 4: 23 August 2002

PURPOSE

The purpose of this paper is to establish the process and metrics of the Property Management Incentive Fee Structure.

BACKGROUND

The Property Management Incentive Fee is part of the overall property management fee structure. The maximum Incentive Fee portion is 2% of net rental income. The Incentive

Fee portion is significant and is equal to 40% of the total property management fee available to be earned by Picerne Management /FM. LLC. The Incentive Fee will be awarded on a quarterly basis.

The Incentive Fee is calculated on a monthly basis at a full 2 and on a monthly basis the fee amount is placed into the Property Management Fee Reserve Account. At the end of the quarter, the incentive fee process is implemented and then approximately thirty days following the end of the quarter, the Trustee releases all or a portion of the Incentive Fee for the previous quarter as earned by Picerne Management /FM. Any unearned fee for the previous quarter is then placed into the Construction Revenue Account as a contribution to capital sources.

STATUS

The CDMP outlined four metrics for measurement that have been revised by the Management Council. The revised new metrics now total five and measure customer service, maintenance response, occupancy, budget, and quality of life. Each of the metrics is weighted equally at 20 and is measured on a quarterly basis.

PROCESS

The incentive fee metrics will be measured and summarized, under the direction of the Installation Commander, within 20calendar days following the end of each quarter. The results of each quarterly measurement process will be made available to Picerne Management /FM. Following the measurement period, the Commander has 8 days to finalize the award amount and submit the signed award to Picerne Management /FM for payment processing through the Trustee.

Incentive Fee Metrics

1. **Customer Service:** The customer service metric will be valuated through resident survey. Picerne Management will send surveys by mail to 25% of the occupied homes (different 25% each quarter). The surveys will be sent in equal

proportion to each of neighborhoods in accordance with their respective occupancy. The estimated number of surveys to be mailed to residents in October 2002 is projected to be 500 based on occupancy of 2,000 homes. Of The 500 surveys, 100 will be executed by the Resident Liaison Office by telephone or door-to-door. Additionally, the surveys will be available on the Meade-Picerne website. Each survey will have a control number that the resident can enter into the computer to fill out the survey online.

The survey will have ten questions ratable on a scale of 1 to 10 relating to neighborhood appearance, management services, and maintenance services. Additionally, the survey will have five climate questions pertaining to quality of life that will be scored with the fifth metric. Lastly, there will be five additional open-ended and non-scored questions to obtain feedback beyond the ratable questions. To encourage residents to complete surveys, Picerne Management /FM will offer six \$100 cash prizes via a drawing conducted by the Resident Liaison Office.

The 20% for the first metric will be awarded on a pro rata basis from a base rating of 6.5. If Picerne Management /FM receives an average overall score of 6.5 or higher, the full 20% for this metric will be credited to Picerne Management /FM. A score of less than 6.5 will be calculated as a percentage of the 20%. For example, a rating of 5.0 would be 77% of the potential 100% (6.5). As a result Picerne Management /FM would receive 15% for the first metric (of the 20% potential).

2. Maintenance Service: The maintenance service metric will be evaluated based on Picerne Management /FM's completion of maintenance requests. The CDMP provides three categories of maintenance services: emergency, urgent, and routine. Each category will have an individual listing of tasks and will have an average completion response time associated with the category. Picerne Management /FM will track all requests through its Yardi work order system. At the end of each quarter, Picerne Management /FM will compile the maintenance service data and present it to the Resident Liaison Office who may test the data. A full 20 portion of the second metric will be awarded if Picerne Management /FM meets or exceeds an 85 average response completion time on an aggregate category basis. As per the customer service metric, Picerne Management /FM can receive something less than 20 for this metric based on the same pro rata computation.
3. Financial: The financial metric is based on actual operating expenses versus budgeted operating expenses. Picerne Management /FM will receive a full 20 for this metric if it operates within plus or minus five percent of the budget for controllable expenses. Controllable expenses are payroll, supplies, administration, maintenance, insurance, and advertising and marketing, and miscellaneous operating expenses. Expenses excluded from the calculation are utilities and management fee. Events beyond the control of Picerne Management /FM that cause the budget to be exceeded shall be taken into

account. Such events include but are not limited to, labor shortages, strikes, severe weather, acts of nature, material cost spikes, etc. If actual operating expenses exceed the budget, a portion of the 20% for this metric will be received by Picerne Management /FM based on a similar pro rata computation as the first metric.

4. **Occupancy:** The occupancy metric is based on actual occupancy versus budgeted occupancy for the quarterly period. Picerne Management /FM will receive a full 20 for this metric if occupancy meets or exceeds the budgeted occupancy. If actual occupancy falls below the budget, a portion of the 20 for this metric will be received by Picerne Management /FM based on a similar pro rata computation as the first metric.
5. **Quality of Life:** The quality of life metric is based on the five quality of life resident survey questions. The questions are similar to those surveyed in the ARMY'S annual housing survey. The five questions are also rated on a 1 to 10 scale.

The 20% for this last metric will be awarded on a pro rata basis from a base rating of 6.5. Surveys not returned will be designated as "satisfied customer" with a 7.5 rating. If Picerne Management /FM receives an average overall score of 6.5 or higher, the full 20% for this metric will be credited to Picerne Management /FM. A score of less than 6.5 will be calculated as a percentage of the 20%. For example, a rating of 5.0 would be 77% of the potential 100% (6.5). As a result, Picerne Management /FM would receive 15% for the last metric (of the 20% potential).

The five metrics listed above are intended to serve as quantitative measurements of Picerne Management /FM's property management performance. Final award of the Incentive Fee is subject to review and adjustment by the Installation Commander. All metrics will be reviewed annually.

Figure C - 1: Artist's Rendering of Neighborhood Center in Monterey



Source: From Monterey RCI website

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Figure D - 1: Artist's Rendering of Greek Revival, Junior NCO's Quarters



Source: from the Monterey RCI website

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